

**REPORT
ON
SALE OF GOODS**

ONTARIO LAW REFORM COMMISSION

VOLUME I



**Ministry of the
Attorney
General**

1979



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**REPORT
ON
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ONTARIO LAW REFORM COMMISSION

VOLUME I



**Ministry of the
Attorney
General**

1979

The Ontario Law Reform Commission was established by section 1 of *The Ontario Law Reform Commission Act* to further the reform of the law, legal procedures and legal institutions. The Commissioners are:

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TABLE OF CONTENTS

VOLUME I

	Page
List of Frequently Cited Sources and Abbreviations	xix
Letter of Transmittal	xxi
PART I	
INTRODUCTION	
Chapter 1 ORIGIN OF PROJECT, ORGANIZATION AND METHODOLOGY	3
Chapter 2 EVOLUTION OF MODERN SALES LAW	7
1. The Anglo-Canadian Position	7
2. Post-1893 Developments	8
3. The Quebec Position	11
4. American Sales Law	12
(a) The Pre-Code Position	12
(b) The Origins of the Uniform Commercial Code	13
(c) The Structure of the Uniform Commercial Code and Some General Considerations	14
(d) Article 2	16
(e) Uniform Land Transactions Act	18
5. International Developments	19
(a) The Hague Conventions of 1964	19
(b) UNCITRAL	21
(c) UNIDROIT	22
(d) The International Chamber of Commerce	22
(e) United Nations Economic Commission for Europe	22
Chapter 3 THE NEED FOR A REVISED SALE OF GOODS ACT: ITS FORM AND RELATED QUESTIONS	23
1. The Lawyer's View	23
2. Businessmen's Attitudes	25
3. What Kind of Revised Act?	26
4. Aids to Interpreting the Revised Act	29

	Page
5. Retaining Uniformity With the Common Law Provinces ..	30
6. Greater Harmonization Between the Laws of Ontario and Quebec	30
7. Should Ontario Adopt a Commercial Code Along the American Model?	31
8. A Law of Contract Amendment Act	32
Recommendations	32

PART II

Chapter 4 SCOPE OF THE SALE OF GOODS ACT AND DEFINITION OF SALE	37
1. Introduction	37
2. The Character of the Parties to the Agreement	38
3. The Character of the Agreement	40
(a) Meaning of “General Property”	40
(b) Sale Incidents in Conditional Sale Agreements	43
(c) Sale of a Part Interest	44
(d) Contracts of Sale and Contracts for Work and Materials	45
(e) Agency Contracts for Sale, Consignment Contracts, and Contracts of Sale or Return	48
(f) Contracts of Bailment, Equipment Leases and Hire-Purchase Agreements	49
4. The Meaning of “Goods”	53
(a) “All Chattels Personal”	53
(b) “Specially Manufactured Goods”	54
(c) “Things in Action”	54
(d) “Money”	55
(e) “Unborn Young of Animals”	55
(f) Goods and Land	57
(i) Anglo-Canadian Position	57
(ii) The Code Provisions	60
(iii) Conclusions	63
(g) Recommended Definition of “Goods”	64
5. The Price	65

	Page
6. Near Sales — Integration or Analogy?	65
Recommendations	68
PART III	
Chapter 5 FORMATION, FORM AND ASSIGNMENT OF CONTRACT ..	75
1. Introduction	75
2. Capacity to Contract and Contracts for Necessaries	76
3. Offer and Acceptance	76
(a) UCC 2-206: Acceptance by Performance	76
(b) The Battle of the Forms	81
(c) Sales by Auction	86
4. Consideration	90
(a) Firm Offers	91
(b) Contractual Modifications	96
(i) The Existing Position	96
(ii) Proposals for Change	99
(c) Should the Effect of Seals be Abolished?	102
5. Mistake	103
(a) <i>Res Extincta</i>	103
(b) Mistakes of Identity	106
(c) Wider Proposals for Reform	106
6. Formalities of Formation (Statute of Frauds Requirements)	107
(a) Introduction	107
(b) Some Empirical Data	108
(c) Abolition Versus Modification: UCC 2-201	110
7. The Parol Evidence Rule	110
(a) The Problem	110
(b) Alternative Solutions	114
(c) Conclusion	115
(d) Consequential Issues	116
8. Course of Performance and Construction of Agreement ..	117
9. Assignment of Rights and Delegation of Performance	119
(a) The Formalities of Assignment	120

	Page
(b) The Scope of The Personal Property Security Act	121
(c) The Status of 'No Assignment' Clauses	121
(d) Modification of Contractual Rights after Assignment	124
(e) Other Aspects of UCC 2-210	125
10. Privity of Contract and Contracts for the Benefit of Third Parties	128
Recommendations	128
 PART IV GENERAL OBLIGATIONS AND CONSTRUCTION OF THE CONTRACT	
INTRODUCTION	133
 Chapter 6 DEFINITION OF EXPRESS WARRANTY AND CLASSIFICATION OF CONTRACTUAL OBLIGATIONS	135
A. Definition of Express Warranty	135
1. Recapitulation	135
2. Definitional Issues	137
(a) Character of Representor	137
(b) Types of Representation	138
(c) Time of Representation	138
(d) Deemed Adoption of Representation by Others ..	138
(e) The Reliance Factor	139
(f) Negligence as a Material Factor	139
(g) Language of Commendation	140
(h) Measure of Damages for Breach of a Non- Promissory Warranty	140
(i) Should the Expanded Definition of Warranty be Applied to other Types of Contract?	141
(j) Conclusion: Draft Provision	141
3. Other Issues	142
B. Classification of Contractual Obligations	145
Recommendations	150

	Page
Chapter 7 FREEDOM OF CONTRACT AND MINIMUM BEHAVIOURAL STANDARDS: THE DOCTRINES OF UNCONSCIONABILITY AND GOOD FAITH IN PERFORMANCE AND ENFORCEMENT	153
A. The Doctrine of Unconscionability	153
1. The General Issue	153
2. Specific Questions	156
(a) Should the Doctrine be Confined to Consumer Sales?	156
(b) Should the Doctrine be Restricted to Cases of Procedural Unconscionability?	157
(c) Should There be a List of Criteria to Guide the Court in Its Determination of the Issue?	157
(d) Should the Court be Able to Raise the Issue of Unconscionability of Its Own Accord?	159
(e) What Types of Relief?	159
(f) Disclaimer of Unconscionability Defences	160
3. Legislative Proposal	160
4. A Cautionary Note	162
B. Good Faith in Performance and Enforcement	163
1. Introduction	163
2. Code Provisions	164
3. Second Restatement on Contracts	166
4. Conclusions	166
5. Good Faith in Bargaining	169
Recommendations	169
Chapter 8 COURSE OF DEALING AND USAGE OF TRADE, AND SOME SPECIFIC CONSTRUCTIONAL ISSUES	173
1. Course of Dealing and Usage of Trade	173
(a) Course of Dealing	173
(b) Usage of Trade	174
(i) Universal Acceptance	175
(ii) Certainty	175
(iii) Reasonableness	176
(iv) Inconsistency	176

	Page
(c) Conclusion	177
2. Uncertainty of Terms	177
(a) General Considerations	177
(b) Uncertainty as to Price	178
(c) Output, Requirements, and Exclusive Dealings Contracts	181
(i) Output and Requirements Contracts	181
(ii) Exclusive Dealings Contracts	184
(d) Contracts of Indeterminate Duration	185
(e) Options and Cooperation Respecting Performance	188
Recommendations	190
 Chapter 9 THE SELLER'S IMPLIED WARRANTIES (CONDITIONS) OF TITLE, DESCRIPTION AND QUALITY AND THE EFFECTIVENESS OF DISCLAIMER CLAUSES	193
1. Title, Quiet Possession, and Freedom from Encumbrances	193
(a) The Implied Condition of Title: Section 13(a)	195
(b) Implied Warranty of Quiet Possession	196
(c) Implied Warranty of Freedom from Encumbrances	197
(d) Implied Warranty of Absence of Infringements	198
(e) Seller's Right to Cure Defective Title and Buyer's Right to Recover Payments on Rescission for Breach of Warranty of Title	199
(f) Disclaimer of Title Obligations Implied by Section 13	199
2. The Implied Condition of Description	201
(a) Anomaly and Retention	202
(b) Sales in Self-Service Stores	203
(c) Seller's Liability for Description of Goods by Third Party	204
3. The Implied Conditions of Quality and Fitness	206
(a) General Considerations	206
(b) The Implied Condition of Merchantability	208
(i) Sale "By Description"	208
(ii) Character of Seller	209
(iii) Sales by an Agent	209
(iv) Meaning of "Merchantable Quality"	210

	Page
(1) General Considerations	210
(2) "Purpose or Purposes"	214
(3) Used Goods	214
(4) Durability	215
(5) Spare Parts and Repair Facilities	216
(6) Other Specifications of Merchantability	217
(v) Effect of Buyer's Examination	218
(vi) Conclusion: Draft Provision	219
(c) The Implied Condition of Fitness	220
4. Sale by Sample	222
5. Implied Warranties in a Lease of Goods	223
6. Cumulation and Conflict of Express and Implied Warranties	226
7. Regulation of Disclaimer Clauses	227
(a) A General Approach	227
(b) Specific Issues	230
(i) Construction of Terms that Limit or Negate Express Warranties	230
(ii) Guidelines Concerning Exclusion or Modification of Implied Warranties: UCC 2-316	231
(iii) Disclaimer Clauses Deemed <i>Prima Facie</i> Unconscionable	232
(iv) Disclaimer Clauses in Non-Privity Cases	234
(v) Deemed Adoption of Disclaimer Clauses by Retailer	235
Recommendations	237
 Chapter 10 EXPRESS AND IMPLIED WARRANTIES AND THE DOCTRINE OF PRIVITY	243
1. The General Issue	243
2. Our Own Position	247
3. Draft Provision and Consequential Issues	248
(a) Types of Seller	250
(b) Types of Subsequent Buyer and Members of Buyer's Household	250
(c) Types of Product	250
(d) Types of Warranties	251
(e) Buyer's Remedies for Breach of Warranty	252
(f) Types of Injury	252
(g) Restrictions Binding on the Buyer	253
(h) Other Consequential Issues	255

PART V

TRANSFER OF PROPERTY (TITLE) IN GOODS

INTRODUCTION	257
Chapter 11 TRANSFER OF TITLE AND ITS INCIDENTS BETWEEN SELLER AND BUYER	
1. Defects in Existing Law	259
2. The Code Approach	262
(a) Special Property and Insurable Interest	263
(b) Buyer's Right to Goods on Seller's Insolvency	265
(c) Risk of Loss	265
(i) General Observations	265
(ii) Issues Arising out of Section 2-509 and Related Questions	269
(1) Shipment Contracts	269
(2) Meaning of "Bailee"	271
(3) UCC 2-509(3)	271
(4) Duties as Bailee of Goods	272
(5) Deterioration of Goods in Transit	273
(d) Risk of Loss — Effect of Party's Breach (UCC 2-510)	273
(i) Delivery of Non-Conforming Goods	274
(ii) UCC 2-510(2)	274
(iii) UCC 2-510(3)	275
(iv) Conclusion	275
(e) Action for the Price	275
(f) Sales on Approval and Contracts of Sale or Return	276
(g) Entitlement to Sue for Tort Damages	276
(h) Residual Title Provision	278
Recommendations	280

VOLUME II

Chapter 12 THE 'NEMO DAT' DOCTRINE AND SALE TRANSACTIONS	
1. Introduction	283
2. The <i>Nemo Dat</i> Doctrine: Removing Existing Anomalies and Uncertainties	285
(a) Sales Under a Voidable Title	285
(b) Seller or Buyer in Possession	288
(i) Technical Questions	289

	Page
(1) Status of Person in Possession	289
(2) The Doctrine of Constructive Notice and the Effect of Registration of the Sale Agreement	290
(3) <i>Newtons of Wembley v. Williams</i>	291
(4) <i>Brandon v. Leckie</i>	293
(5) The Meaning of “Sale, Pledge, or Other Disposition”	293
(6) Sales on Approval and Contracts of Sale or Return	294
(7) Documents of Title	295
(ii) The Broader Questions of Principle	296
(c) Entrusted Goods and Sales in Ordinary Course: <i>The Factors Act</i> , Section 2; <i>The Conditional Sales Act</i> , Section 2(3) (Now Repealed); and, <i>The Personal Property Security Act</i> , Section 30(1)	298
(d) Registration Requirements, Grace Periods, and Temporarily Perfected Security Interests	301
(e) <i>The Bills of Sale Act</i>	302
(f) Some Tentative Conclusions	305
3. Should Ontario Adopt a General <i>Possession Vaut Titre</i> Rule?	306
(a) The Civil Law Position	306
(b) Arguments For and Against the Adoption of the <i>Possession Vaut Titre</i> Rule in Ontario	307
4. Rejection of <i>Possession Vaut Titre</i> ; Affirmation of <i>Nemo Dat</i>	308
(a) Sales Under a Voidable Title	309
(b) Should Section 25 of <i>The Sale of Goods Act</i> be Repealed?	309
(c) Should Owners of Goods be Subject to a Duty of Reasonable Care with Respect to Their Entrustment?	310
(d) Entrustment of Goods to a Merchant, or Adoption of a General <i>Market Overt</i> Rule with Respect to Sales Made at Retail Premises	311
(e) Residual Questions	313
Recommendations	316
Chapter 13 DOCUMENTS OF TITLE	319
1. The Need for Comprehensive Codification	319
2. Definition of “Document of Title”	322
3. Basic Issues in the Sales Context	324
(a) The Passing of Property	324

	Page
(b) Risk of Loss	325
(c) Documents of Title and the Seller's Delivery Obligations	326
(i) Goods Held by a Bailee That Are Not to be Shipped	326
(ii) Goods Authorized or Required to be Shipped....	327
(d) The Unpaid Seller's Right to Withhold and Stop Delivery	327
(i) As Against the Buyer	327
(ii) As Against Third Parties	328
(e) Transfer of Title and Good Faith Buyers	328
Recommendations	329
 Chapter 14 DELIVERY AND PAYMENT	331
A. Delivery	331
1. Introduction	331
2. Time of Delivery	333
3. Place and Form of Delivery	335
(a) Sales Not Involving Shipment	335
(i) Delivery at Seller's Place of Business or Residence	335
(ii) Delivery of Goods in Possession of Another	336
(b) Sales Involving Shipment	338
(c) Character and Effect of Seller's Reservation of Right of Disposal	341
4. The Use of Mercantile Terms	346
(a) Which Model?	347
(b) Impact of Containerization	348
B. Buyer's Obligation to Pay	350
1. Time of Payment	350
2. Payment Before Inspection	352
3. Sufficiency and Form of Payment	354
4. Place of Payment	355
5. Letters of Credit	355
6. Rights of Financing Agency	358
Recommendations	361
 Chapter 15 FRUSTRATION IN CONTRACTS OF SALE	365
1. Introduction	365
2. <i>The Sale of Goods Act</i> , Section 8	365
3. <i>Uniform Sales Act</i> , Section 8	369

	Page
4. Code Provisions	369
(a) UCC 2-613	370
(b) UCC 2-614	373
(c) UCC 2-615	374
(d) UCC 2-615(c) and 2-616	379
5. Effects of Frustration and <i>The Frustrated Contracts Act</i>	381
Recommendations	382

PART VI

SELLER'S AND BUYER'S REMEDIES FOR BREACH OF CONTRACT

INTRODUCTION	387
Chapter 16 SELLER'S REMEDIES	389
1. Index of Seller's Remedies and Characterization of Buyer's Breach	389
2. Real Remedies	394
(a) The Existing Law	395
(i) The Relevance of Title	395
(ii) Lien Right (Right of Retention)	396
(1) Seller in Possession as Agent	397
(2) Part Delivery	397
(3) Effect of Judgment on Lien	398
(4) Non-Possessory Lien Rights Where Buyer Insolvent; UCC 2-702	398
(5) Should the Seller's Lien Right Cover Damages or Expenses as well as the Unpaid Price?	399
(iii) Right of Stoppage <i>In Transitu</i>	400
(iv) Right of Resale	401
(v) Residual Questions	403
(b) The Code Position	404
(i) The Right to Withhold Delivery	404
(ii) Stoppage <i>In Transitu</i>	405
(iii) Right of Resale	408
(1) Buyer's Right to Cure	411
(2) Notice of Resale	412
(3) Buyer's Entitlement to Surplus Proceeds....	413

	Page
3. Personal Remedies	414
(a) Action for the Price	415
(b) Damages	418
(c) Penalty Clauses and Forfeiture of Monies Paid	423
(i) Penalty Clauses	423
(ii) Forfeiture of Monies Paid	425
4. Lessor's Remedies for Breach of Lease Agreement	426
Recommendations	427
 Chapter 17 BUYER'S REMEDIES	433
A. Index of Buyer's Remedies and Characterization of Seller's Breaches	433
B. Specific Performance and Other Forms of Specific Relief	436
1. Section 50 of <i>The Sale of Goods Act</i>	436
2. The Uniform Commercial Code Provisions	440
3. Conclusions	443
C. Rejection, Acceptance and Cure	444
1. General Considerations	444
(a) The Anglo-Canadian Position	444
(i) Limitations on the Right to Reject	445
(1) Acceptance of the Whole or Part of a Non-Severable Consignment and Sale of Specific Goods: s. 12(3)	446
(aa) Acceptance of Goods in a Non- Severable Contract	446
(bb) Acceptance of Part of a Non- Severable Consignment	446
(cc) Sale of Specific Goods	448
(2) The <i>De Minimis</i> Rule	449
(3) Some Miscellaneous Restrictions on the Right to Reject	449
(ii) Acceptance of the Goods	450
(b) The American Position	451
(c) The ULIS and UNCITRAL Approaches	456
(i) ULIS	456
(ii) Draft UNCITRAL Convention	458

	Page
(d) Conclusions with Respect to Rights of Rejection and Cure	459
(i) Right of Rejection	459
(ii) Seller's Right to Cure and Buyer's Right to Demand Cure	461
(1) Seller's Right to Cure	461
(aa) When Does the Right to Cure Arise?	463
(bb) Nature of Non-Conformity	464
(cc) Nature of "Cure"	464
(dd) Status of Buyer's Obligations	465
(2) Buyer's Right to Demand Cure	465
2. Further Consideration of Examination, Acceptance and Revocation of Acceptance	467
(a) Place of Examination	467
(b) Acceptance of Goods	469
(c) Revocation of Acceptance	472
3. Some Consequential Problems Following the Exercise of Rejection Rights; and Buyer's Duty to Give Notice of Breach After Acceptance	475
(a) Buyer's Powers and Obligations with Respect to Goods	475
(b) Duty to State Grounds of Rejection and Comparison with Buyer's Duties to Give Notice of Breach or Suit by Third Party	477
(i) Duty to State Grounds of Rejection	478
(ii) Comparison with Buyer's Duties to Give Notice of Breach After Acceptance, or to Give Notice of Suit by Third Party	479
(c) Buyer's Lien Rights	482
(d) To What Extent Do the Code Provisions Apply to Wrongfully Rejected Goods?	483
D. The Buyer's Claim for Damages	484
1. General Principles of Liability — Has the Pendulum Swung too Far?	484
2. Damage Claims in Private Sales	489
3. The Computation of Damages Under the Rules in <i>Hadley v. Baxendale</i> : Some Particular Problems	491

	Page
(a) The Foreseeability Test	491
(b) Comparison with Article 2 Provisions	494
(c) The Right to Cover	498
(d) Sub-contracts, the Foreseeability Tests, and Mitigation Principles	499
(e) Impecuniosity	502
(f) Goods for Use: the “Rema” Problem	503
E. Restitutionary Remedies	504
Recommendations	509
 Chapter 18 ISSUES COMMON TO SELLER’S AND BUYER’S REMEDIES	517
1. Meaning of “Substantial Breach”	517
(a) Terminology	517
(b) Definition	518
(c) Single or Multiple Tests?	519
(d) Repudiation and Breach	520
2. The Market Price Test	521
(a) Measure of Damages: “Available Market” or “Commercially Reasonable Purchase or Disposition”	521
(b) The Place for Determination of Commercially Reasonable Price	524
(c) The Time for Determination of Commercially Reasonable Price	525
(d) Conclusions	527
3. Assurance of Performance	528
4. Anticipatory Repudiation	532
(a) Comparison of Anglo-Canadian and American Positions	532
(b) Conclusions	535
(i) Meaning of Repudiation	535
(ii) Meaning of UCC 2-610(a)	536
(iii) Effect of Urging Retraction: UCC 2-610(b) ...	537
(iv) Avoidance of Unjustifiable Expenditures and Duty to Mitigate	538
(v) Measurement of Damages	539
5. Instalment Contracts	541
(a) Meaning of “Instalment Contract”	541
(b) Breach of Instalment Contract by Seller	547
(i) Effect of Breach as to Instalment Upon the Balance of the Contract	547

	Page
(ii) Effect of Breach of the Whole Contract on Previously Accepted Instalments	549
(iii) Breach with Respect to a Single Instalment	551
(c) Breach of Instalment Contract by Buyer	552
(d) Reinstatement of the Contract	553
(e) Conclusion	554
Recommendations	554
PART VII	
Chapter 19 MISCELLANEOUS ISSUES	561
1. Applicability of Revised Act to Crown	561
2. Limitation Period	562
3. Conflict of Laws Provisions	564
4. Transitional Provisions	564
5. Conflicting Legislation	565
Recommendations	567
Conclusion	568
VOLUME III	
APPENDICES	
1. Draft Bill to Revise <i>The Sale of Goods Act</i>	1
2. <i>The Sale of Goods Act</i> , R.S.O. 1970, c. 421	67
3. Selected Provisions of Article 1 of the <i>Uniform Commercial Code</i>	85
4. Article 2 of the <i>Uniform Commercial Code</i> (as amended) ..	89
5. United Nations Commission on International Trade Law (UNCITRAL), Draft Convention on the International Sale of Goods (1977)	137
6. Resolution of the Council of the Ontario Branch of the Canadian Bar Association, September 29, 1969	155
7. Report of the Sub-Committee on Article 2 of the <i>Uniform Commercial Code</i> to the Commercial Law Subsection, Ontario Branch, Canadian Bar Association	157
8. List of Research Papers prepared in the Sale of Goods Project of the Ontario Law Reform Commission	171
9. Francis A. Miniter, "Comparative Analysis of Shipping Terms in <i>INCOTERMS</i> 1953 and Supplement and in Article 2 of the <i>Uniform Commercial Code</i> " (edited version)	173
10. John D. McCamus, "The Frustrated Contracts Act: Proposals for Reform"	201

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Ontario
Law Reform
Commission

Sixteenth Floor,
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To The Honourable R. Roy McMurtry, Q.C.,
Attorney General for Ontario

Dear Mr. Attorney:

We have the honour to submit herewith our Report on Sale of Goods.

PART I
INTRODUCTION

CHAPTER 1

ORIGIN OF PROJECT, ORGANIZATION AND METHODOLOGY

The present Project began in February, 1970, with a Reference to the Ontario Law Reform Commission from the then Minister of Justice and Attorney General, the Honourable A. A. Wishart, Q.C. Pursuant to this Reference the Commission undertook a study of the Ontario Sale of Goods Act with a view to assessing the adequacy of this Act in the light of contemporary conditions and making recommendations with respect to the desirability of change. The Reference was inspired by a submission to the Minister of Justice by the Ontario Branch of the Canadian Bar Association, a submission which, in turn, was based upon a recommendation of the Commercial Law Subsection of the Association. This Sub-section had previously struck a special Sub-Committee to study Article 2 of the American *Uniform Commercial Code* and to recommend to what extent the Article was suitable for adoption in Ontario. The Sub-Committee reached the conclusion¹ that *The Sale of Goods Act*² was deficient in important respects and that Article 2 "should be enacted in the Province of Ontario . . .".

Preliminary steps for the organization of the study requested by the Minister of Justice were taken by the Commission in 1970; before they could be completed, however, the Commission received a further and joint request from the Minister of Justice and the then Minister of Financial and Commercial Affairs, the Honourable A. B. R. Lawrence, Q.C., inviting the Commission to give first priority to a study of the law of warranties and guarantees in the context of consumer sales. The Commission agreed to this request and it was also agreed that the warranties study should constitute an integral part of the wider Sale of Goods Project. The Commission's *Report on Consumer Warranties and Guarantees in the Sale of Goods* was published in June, 1972.

Serious work on the main Project was resumed in the summer of 1972. The development of the Project proceeded in three distinct phases. During the first phase, a Research Team directed by Professor Jacob S. Ziegel, formerly of the Osgoode Hall Law School, York University, and now of the Faculty of Law, University of Toronto, prepared research papers and memoranda on a number of topics approved by the Commission. These research papers are listed in an appendix to this Report.³ The results of this research and the collective recommendations of the Research Team were then summarized and supplemented in a lengthy Research Report to the Commission, prepared by Professor Ziegel. It was thereafter the task of the Commission to embark upon a long and detailed

¹The Report of the Sub-Committee is reproduced as Appendix 7 to this Report.

²Now R.S.O. 1970, c. 421.

³See, Appendix 8.

analysis of the Research Report, a task which may be considered the second phase of the Project. During this protracted analysis, the Commission reached its own decisions with respect to all issues canvassed in the Research Report. Professor Ziegel and several of his colleagues were then requested to prepare a Draft Bill of a revised Sale of Goods Act incorporating the Commission's decisions. The results of their efforts occupied the Commission's attention during the third phase of the Project. The Draft Bill, as extensively revised by the Commission, appears as an appendix to this Report.⁴

The research undertaken during the first phase of the Project fell, in turn, into two distinct parts. The first, which has already been mentioned, consisted of the preparation of research papers on specific topics in the law of sales and related areas in the law of contracts. The second part comprised a series of empirical studies which were designed to elicit information concerning current selling and purchasing practices in Ontario, particularly at the manufacturing level. It was hoped that such information would throw helpful light on the significance and adequacy of the existing rules of law. With the assistance of the Ontario Branch of the Canadian Manufacturers' Association, a very detailed questionnaire was distributed among members of the Association in August, 1972. This questionnaire produced 835 replies, of which 824 were received in time for detailed analysis and tabulation.⁵ The replies produced a wealth of information which proved very helpful to individual members of the Research Team in the preparation of their papers, and which may also provide assistance to future researchers.

The statistical inquiry was supplemented in several respects. First, an in-depth survey was conducted by Professor Michael Munson, then a member of the Faculty of Administrative Studies of York University, on the selling and purchasing practices of 25 representative businesses in Metropolitan Toronto.⁶ Secondly, interviews and correspondence were conducted by Professor Ziegel and individual members of the Research Team with other companies and important trade associations. Thirdly, an analysis of contractual terms and warranty documents was compiled from materials received from respondents to the C.M.A. Questionnaire.⁷

An attempt was also made to solicit suggestions and observations from members of the business community and the legal profession through advertisements placed in widely circulating newspapers and in the Ontario Reports; however, these produced negligible results.⁸ Equally disappointing was the response to a questionnaire dealing with legal questions relat-

⁴See, Appendix 1.

⁵The results are analyzed in Mr. Barry D. Fisher's "Analysis of Computer Tabulation of Responses to Questionnaire Distributed to Ontario Members of the Canadian Manufacturers' Association", Research Paper No. I.2.

⁶See, J. Michael Munson, "A Descriptive Overview of Marketing Functions as Perceived and Performed by the Entrepreneur", Research Paper No. I.3.

⁷See, Paul Perell, "Analysis of Contractual Terms and Warranty Documents Based on Material Received from O.L.R.C. — C.M.A. Questionnaire Respondents", Research Paper No. I.4.

⁸The same was true of a news release issued by the Commission on March 2, 1972, announcing the Project and inviting submissions.

ing to *The Sale of Goods Act*, which was distributed in the summer of 1973 and later among a representative group of trade associations and organizations. The significance of this apparent apathy will be discussed in a later part of the Report.⁹

We wish to express our sincere appreciation to our Project Director, Professor Jacob S. Ziegel. This Report reflects not only his scholarship and abundant talents, but also his patience and dedication to the task of law reform. We are pleased to record our debt to Professor Ziegel.

We are also pleased to acknowledge the contribution of members of the Research Team who gave so fully of their time and talents: Professor Marvin Baer, Professor Christopher Carr, Mr. Bradley Crawford, Mr. Norman May, Q.C., Professor John McCamus, Professor Allen J. Myers, Professor J. Michael Munson, Professor W. A. W. Neilson, Professor Michael J. Trebilcock, and Professor Stephen M. Waddams.

We also wish to thank Mr. L. R. MacTavish, Q.C., former Senior Legislative Counsel, for his assistance in the preparation of the Draft Bill. It would not have been possible to put forward this long and complex piece of legislation without the patience and expertise of Mr. MacTavish.

We would be remiss if we were not also to mention the large number of dedicated law students who worked on the Project. In particular, we wish to acknowledge the important contributions of Mr. Barry D. Fisher, Mr. Paul Perell, and Mr. Francis Miniter. Mr. Fisher played a pivotal role in the preparation of the C.M.A. Questionnaire and in the tabulation and evaluation of the results. Mr. Perell compiled an analysis of contractual terms and warranty documents based on materials received from respondents to the C.M.A. Questionnaire. Mr. Miniter served, diligently and capably, as a research assistant during the summers of 1977 and 1978. To the Canadian Manufacturers' Association we extend our sincere thanks for their cooperation and assistance.

⁹See, *infra*, at pp. 25-26.

1. THE ANGLO-CANADIAN POSITION

The principles of sales law that we know today evolved very slowly and are mainly a product of late 18th century and particularly 19th century developments.¹ The Saxon and Norman periods apparently contributed very little to this branch of the law.² Indeed, in their nature, they were perhaps ill-suited to the development of a law of sales, given the simple and feudal state of the economy, the relative unimportance of personal chattels, and the undeveloped law of contracts. Moreover, severe restrictions were imposed by the actions in debt and detinue, and by the archaic procedures to which these actions were subject. Much more flexible procedures and rules, it would seem, were applied in the local courts in which the law merchant had its medieval origins. But whatever contribution might have been made by these courts towards the accelerated development of a body of sales law was lost when the common law courts assumed exclusive jurisdiction over disputes previously tried in the local courts. The introduction of the action in assumpsit, while laying the theoretical foundations for the modern law, seemingly made little initial impact. Here, as elsewhere, economic and social conditions were the ultimate determinants of the pace of legal development, and the pressure for a detailed body of rules governing the law of sales did not really manifest itself until the arrival of the industrial revolution.

Events moved quickly during the 19th century and, by 1888, it was felt that the rules were sufficiently settled to warrant their being reduced to statutory form. This was the year when MacKenzie D. Chalmers, the author of the highly successful *Bills of Exchange Act, 1882*,³ was encouraged to draft a similar bill embracing the sales area.⁴ As Chalmers himself recorded,⁵ Lord Herschell's advice to him was to endeavour "to reproduce as exactly as possible" the existing law, leaving any amendments that might seem desirable to be introduced in committee on the authority of the legislature. After detailed consideration by both Houses of Parliament, his draft bill was enacted into law in 1894 with one major⁶ and a number of minor changes. Thus was born the *Sale of Goods Act, 1893*.⁷

¹There does not appear to be a systematic treatment of the history of English or Canadian sales law. Holdsworth's *A History of English Law* contains a large number of brief references, rarely exceeding a page in length, scattered among the 17 volumes of his masterpiece.

²Compare, Pollock & Maitland, *History of English Law* (2d. ed., re-issued 1968), Vol. I, pp. 57-60; Vol. II, pp. 207-10.

³45 & 46 Vict., c. 61 (U.K.).

⁴Chalmers' *Sale of Goods Act 1893*, "Introduction to First Edition (1894)", reprinted in 14th ed., pp. ix et seq. See also, Chalmers, "Codification of Mercantile Law" (1903), 19 L.Q.R. 10.

⁵Chalmers' *Sale of Goods Act 1893*, *supra*, at p. x.

⁶The bill was extended to include Scotland.

⁷756 & 57 Vict., c. 71 (U.K.).

2. POST-1893 DEVELOPMENTS

The Imperial Act was quickly copied by most Commonwealth jurisdictions that followed the common law tradition. All of the common law provinces in Canada have enacted like legislation, albeit with a number of minor changes.⁸ Manitoba was the first enacting province; for some unknown reason Ontario delayed its enactment until 1920.⁹

In the intervening years, the U.K. Parliament, has, on the whole, made few changes to the 1893 Act that are of interest to Canadian lawyers. It should, however, be noted that, as is true in Canada's case, the sales rules codified in the 1893 Act have been affected by important developments in the public law and related private law areas.¹⁰ The most important direct changes¹¹ are those effected by the following statutes:

- (1) The *Law Reform (Enforcement of Contracts) Act 1954*.¹² This Act repealed Section 4, the Statute of Frauds provision, in the parent Act of 1893;
- (2) The *Misrepresentation Act 1967*.¹³ This Act amended the law of misrepresentation in important respects and also amended sections 11(1)(c) and 35 of the *Sale of Goods Act*;
- (3) The *Supply of Goods (Implied Terms) Act 1973*.¹⁴ This Act amended sections 12-14 of the *Sale of Goods Act* and, until superseded by the *Unfair Contract Terms Act 1977*, restricted or excluded the use of exception clauses in consumer sales and other sales transactions, including hire-purchase and conditional sale agreements;
- (4) The *Unfair Contract Terms Act 1977*.¹⁵ This Act, which came into force on February 1, 1978, introduced a comprehensive regime, not restricted to sales transactions, for the restriction or avoidance of exception clauses in consumer and non-consumer agreements.

In 1967 the U.K. Parliament also adopted the *Uniform Laws on International Sales Act 1967*.¹⁶ This Act gives municipal effect to the two Hague Conventions on the Uniform Law on the International Sale of Goods and the Uniform Law on the Formation of Contracts for the International Sale of Goods.¹⁷ However, the Act is of minor importance since it only applies to international sales, as defined in the Conventions, and then only if the

⁸See the table of concordances in Fridman, *Sale of Goods in Canada* (1973), p. xlvi.

⁹S.O. 1920, c. 40.

¹⁰The related legislation is summarized in Benjamin's *Sale of Goods* (1974), paras. 12-17. To this list there may now also be added the *Consumer Credit Act 1974*, c. 39 (U.K.).

¹¹For a complete list of the repeals and amendments up to 1974, see Benjamin, *supra*, para. 18.

¹²2 & 3 Eliz. 2, c. 34 (U.K.).

¹³1967, c. 7 (U.K.).

¹⁴1973, c. 13 (U.K.).

¹⁵1977, c. 50 (U.K.).

¹⁶1967, c. 45 (U.K.).

¹⁷See, *infra*, this chapter, section 5(a).

parties have expressly adopted the Uniform Law on Sales as the law of their contract.¹⁸

This description of the British position would be seriously incomplete if it did not also include a reference to the recommendations contained in a number of important reports and working papers published by the English Law Commission and Law Reform Committee.¹⁹ While these recommendations have not yet been implemented, the reports and working papers have been very helpful to us in our own deliberations. It should also be noted that, since the enactment of the *Sale of Goods Act, 1893*, the basic law of contract and tort has undergone substantial judicial development, and that this judicial development has had an impact on the law of sales. Whether the judicial creativity has been sufficient to offset the deficiencies in the Act will be discussed in later parts of this Report.

Legislative activity in Commonwealth countries, other than Canada, does not appear to have been more pronounced. Ghana adopted a slightly revised version of the U.K. Act in 1962.²⁰ The New South Wales Law Reform Commission published a Working Paper in 1975²¹ recommending substantial changes to the New South Wales Sale of Goods Act.²² We have derived great benefit from this Working Paper, but it does not purport to cover all aspects of the existing law or even all important aspects.

The U.K. statutory changes so far have had a limited impact in Canada. Only British Columbia has copied the 1954 amendment,²³ and only one province, Saskatchewan, has adopted any of the 1973 amendments, and then only to a very limited extent.²⁴ However, disclaimer provisions, comparable to those in the 1973 Act, were anticipated in the Con-

¹⁸Benjamin, footnote 10 *supra*, para. 17. See, generally, Graveson, Cohn & Graveson, *The Uniform Laws on International Sales Act 1967* (1968).

¹⁹See, for example, Law Reform Committee, *Twelfth Report (Transfer of Title to Chattels)* (1966), (Cmnd. 2958); Law Commission Working Paper No. 60, *Firm Offers* (1975); Law Com. W.P. No. 61, *Penalty Clauses and Forfeiture of Monies Paid* (1975); Law Com. W.P. No. 64, *Liability for Defective Products* (1975); Law. Com. W.P. No. 65, *Pecuniary Restitution on Breach of Contract* (1975); Law. Com. W.P. No. 70, *Law of Contract: the Parol Evidence Rule* (1976). Early in their careers the English and Scottish Commissions embarked on an ambitious project to codify the law of contract of England and Scotland. Had the project been completed it would no doubt have exerted a major influence on the development of future sales law. However, work on the project has now been suspended and the English Law Commission has decided instead to publish working papers on particular aspects of the law that appear in need of amendment. See Law Com. No. 58, *Eighth Annual Report 1972-73*, paras. 3-5; and Law Com. No. 64, *Ninth Annual Report 1973-74*, para. 7.

²⁰See, *Sale of Goods Act, 1962*, Acts of Ghana 1962, No. 137. (There is a hiatus with respect to the correct description of the Act. The present description is taken from the table of contents accompanying the Act.)

²¹Law Reform Commission, New South Wales, *Working Paper on the Sale of Goods* (1975). No final report has been published.

²²The areas canvassed in the Working Paper are: the classification of express statements; the Statute of Frauds writing requirements; parol evidence rule; privity of contract; implied warranties; remedies for breach of warranty; and, frustration.

²³S.B.C. 1958, c. 52, s. 17.

²⁴See, *The Consumer Products Warranties Act, 1977*, S.S. 1976-77, c. 15, s. 11.

sumer Protection Acts of Ontario, Manitoba and British Columbia.²⁵ The *Misrepresentation Act* 1967 has attracted no followers and the prospect of the *Unfair Contract Terms Act* 1977 being copied verbatim seems equally doubtful, in view of the trade practices legislation that already covers a substantial part of the same ground in Ontario and elsewhere.²⁶

This is not to suggest that the legislative scene in Canada has remained static; it has not. A large number of federal and provincial Acts have a direct and very important bearing on the parties' rights and obligations in the sales sector, and their number has rapidly increased in the post-war period. Without attempting an exhaustive enumeration, several statutes are worthy of mention. At the federal level there are the following Acts: namely, the *Bank Act*;²⁷ the *Bills of Lading Act*;²⁸ the *Combines Investigation Act*;²⁹ the *Consumer Packaging and Labelling Act*;³⁰ the *Food and Drugs Act*;³¹ the *Hazardous Products Act*;³² the *Motor Vehicle Safety Act*;³³ the *Textile Labelling Act*;³⁴ and, the *Weights and Measures Act*.³⁵ At the provincial level, legislation of Ontario includes the following enactments: *The Bills of Sale Act*;³⁶ *The Business Practices Act*;³⁷ *The Consumer Protection Act*;³⁸ *The Factors Act*;³⁹ *The Mercantile Law Amendment Act*;⁴⁰ *The Motor Vehicle Dealers Act*;⁴¹ *The Personal Property Security Act*;⁴² and, *The Warehouse Receipts Act*.⁴³ Much of the post-war legislation is consumer oriented, but its impact frequently extends well beyond the law of consumer sales.

The role of the Uniform Law Conference of Canada⁴⁴ should also be noted. Since its establishment in 1918 the Conference has been active in drafting uniform or model acts in the commercial law area and urging their adoption by the provinces. The Conference's efforts now embrace bills of sale and chattel mortgages, conditional sales and personal property security legislation, as well as uniform acts on Warehouse Receipts and Warehousemen's Liens.⁴⁵ The Conference's well-established role is of

²⁵For details, see Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), at pp. 55 et seq.

²⁶For Ontario, see *The Business Practices Act*, S.O. 1974, c. 131. The problem of unconscionable terms is discussed *infra*, in chapter 7.

²⁷R.S.C. 1970, c. B-1, as am.

²⁸R.S.C. 1970, c. B-6.

²⁹R.S.C. 1970, c. C-23, as am.

³⁰S.C. 1970-71-72, c. 41.

³¹R.S.C. 1970, c. F-27.

³²R.S.C. 1970, c. H-3.

³³R.S.C. 1970, c. 26 (1st Supp.).

³⁴R.S.C. 1970, c. 46 (1st Supp.).

³⁵S.C. 1970-71-72, c. 36.

³⁶R.S.O. 1970, c. 44, as am.

³⁷S.O. 1974, c. 131.

³⁸R.S.O. 1970, c. 82, as am.

³⁹R.S.O. 1970, c. 156.

⁴⁰R.S.O. 1970, c. 272.

⁴¹R.S.O. 1970, c. 475, as am.

⁴²R.S.O. 1970, c. 344, as am.

⁴³R.S.O. 1970, c. 489.

⁴⁴Formerly known as the Conference of Commissioners on Uniformity of Legislation in Canada.

⁴⁵For the complete list of acts and the degree of their adoption by the provinces, see the annual *Proceedings* of the Conference.

considerable importance in view of the recommendation made later in this Report⁴⁶ with respect to the desirability of securing the uniform adoption of a revised Sale of Goods Act.

3. THE QUEBEC POSITION

As a civil law jurisdiction, Quebec has never adopted the Sale of Goods Act.⁴⁷ Its law of sales is enshrined in the Quebec *Civil Code*⁴⁸ and owes its origin primarily to the corresponding provisions in the Napoleonic Civil Code. There are numerous differences between the sales law of Quebec and that of the common law provinces. It may be useful to note briefly some of the more important points of departure.

The rules governing the formation of a contract of sale are not the same. Among other differences, written evidence is not required in the case of commercial matters, and in other transactions involving \$500 or less.⁴⁹ Further, the doctrine of *causa* is much more liberal than the common law doctrine of consideration. Thus, even though there is no separate consideration, a "firm" offer cannot, where a period of duration is specified, be revoked during such period.⁵⁰ Moreover, a mailed acceptance is not usually effective until it is received by the offeree.⁵¹ Contracts for the benefit of third parties are enforceable by the beneficiaries.⁵²

The implied warranties also differ in important respects. The legal warranty against latent defects⁵³ is the civil law analogue to the common law condition of merchantable quality; but it is not as potent. In the case of a sale of specific goods, the civil law warranty does not extend to discoverable defects and the buyer is expected, for his own protection, to examine the goods before purchase and, it would seem, in at least some circumstances, to retain technical assistance to enable him to conduct a proper examination.⁵⁴ While the warranty against latent defects, unlike the condition of merchantability in the common law, applies to private as well as to commercial sales, the consequences of a breach of the warranty are not the same. In general, the buyer's remedies are limited to rescission of the agreement or a reduction in the purchase price,⁵⁵ and consequential damages are only allowed if the buyer can show that the seller knew or ought to have known of the defect.⁵⁶

There are other differences, some of which may be mentioned briefly. The effectiveness of disclaimer clauses varies,⁵⁷ though it may be that the

⁴⁶*Infra*, p. 30.

⁴⁷See, generally, Norman May, "Sales of Moveables in Quebec Law", Research Paper No. V.1.

⁴⁸Book III, Title V, arts. 1472-1595.

⁴⁹Que. C. Civ., art. 1233.

⁵⁰*Renfrew Flour Mills v. Sanschagrin* (1928), 45 Que. K.B. 29; *Beaudry v. Randall*, [1962] Que. Q.B. 577; May, footnote 47 *supra*, pp. 9-10.

⁵¹*Charlebois v. Baril*, [1928] S.C.R. 88; May, footnote 47 *supra*, pp. 10-12.

⁵²Que. C. Civ., art. 1029; May, footnote 47 *supra*, pp. 12-14.

⁵³Que. C. Civ., art. 1522.

⁵⁴May, footnote 47 *supra*, pp. 22-25.

⁵⁵Que. C. Civ., art. 1526; May, footnote 47 *supra*, pp. 27-28.

⁵⁶Que. C. Civ., art. 1527; May, footnote 47 *supra*, pp. 28 *et seq.*

⁵⁷May, footnote 47 *supra*, p. 26.

practical result is not very different from that obtaining in the common law provinces. The unpaid seller's *in rem* remedies differ in one important respect insofar as the seller can dissolve the sale and reclaim the goods, even after delivery, so long as they remain in the buyer's possession.⁵⁸ Finally, the *nemo dat* doctrine plays a much less important role in Quebec law. The *Civil Code* protects the good faith purchaser who purchases goods in a fair or market or at a public sale or from a trader dealing in similar articles or "in commercial matters generally", unless the goods have been lost or stolen.⁵⁹ Even in the latter cases the owner is only entitled to recover the goods if he reimburses the purchaser the amount paid by him for the goods.⁶⁰

The number and extent of the differences between Quebec law and the common law rules might suggest serious impediments to the flow of interprovincial trade between Quebec and its important trading partners. The answers to the C.M.A. Questionnaire belie this assumption.⁶¹ Nevertheless, it must remain a matter of regret that the laws of Quebec and Ontario differ so materially in such an important branch of commercial law.⁶² The Quebec Civil Code Revision Office has recently completed a comprehensive review of the *Civil Code*, including the parts relating to sales and obligations, and has submitted proposals for a new Code.⁶³ This development, coupled with Ontario's own desire to modernize its sales law, could provide the two provinces with a valuable opportunity to explore the possibility of securing greater uniformity between their respective laws. We return to this question in a later part of this Report.

4. AMERICAN SALES LAW

(a) THE PRE-CODE POSITION

Nineteenth century American sales law largely followed English principles, but the laws of the individual states differed from each other and

⁵⁸Que. C. Civ., arts. 1065, 1543; May, footnote 47 *supra*, pp. 39-40.

⁵⁹Que. C. Civ., art. 2268, para. 3; and compare, art. 1488.

⁶⁰Que. C. Civ., art. 2268, para. 4.

⁶¹Only 0.4% of the respondents indicated that they "always" encountered difficulties because of differences between the sales law of Ontario and Quebec. The percentages were 0.4% and 0.3% with respect to the other provinces and the U.S. respectively. 89.7% of the respondents indicated that they "never" encountered difficulties in their Quebec dealings or only "rarely": see, Fisher, "Analysis of Computer Tabulation of Responses to Questionnaire Distributed to Ontario Members of the Canadian Manufacturers' Association", Research Paper No. I.2, Table 34, p. 105. It should be emphasized that these replies were received in 1972 and may no longer reflect the current position.

⁶²This sentiment appears to be shared by Professor Crépeau, Chairman of the Civil Code Revision Office. In a letter to Professor Ziegel, dated 14 June 1972, he wrote: ". . . I do firmly believe that there is no fundamental reason why the laws ought to be different from one province to another. The policies of the law are neither civil nor common".

⁶³See, especially, *Report on Obligations*, Report No. XXX (1975), and *Report on Sale*, Report XXXI (1975); and now, Civil Code Revision Office, *Report on Quebec Civil Code* (1977), Vol. I, pp. 331 *et seq.* and pp. 387- 401; and also Minter, "Annual Workshop on Commercial and Consumer Law, 1976: What Was Said" (1978), 2 C.B.L.J. 364, 379 *et seq.*; and Field, "A Common Law Look at the Law of Latent Defects in Quebec and the Proposals for its Reform" (1977), 2 C.B.L.J. 209.

from the English rules on many points of detail and sometimes on points of substance.⁶⁴ An important objective, therefore, of the *Uniform Sales Act* drafted by Professor Samuel Williston of the Harvard Law School, and adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1906, was to reconcile the conflicting state rules and to introduce a uniform body of law. Williston admired Chalmers' Act and followed it closely. Nevertheless a substantial number of differences survived between the *Uniform Sales Act* and the U.K. *Sale of Goods Act*. The more important differences included the following: namely, the wide definition of warranty in the American Act,⁶⁵ which was based on a reliance theory of liability and not restricted to contractual promises; the unitary classification of contractual terms as contrasted with the dichotomous classification of terms in the U.K. Act into warranties and conditions; a significantly different regime of buyer's remedies;⁶⁶ and, the separate treatment of documents of title.⁶⁷

(b) THE ORIGINS OF THE UNIFORM COMMERCIAL CODE

At the time it was superseded by the *Uniform Commercial Code*, the *Uniform Sales Act* had only been adopted by thirty-six states. Williston's work has been called a "scholarly reconstruction of nineteenth century law".⁶⁸ In any event, merchants of the Eastern seaboard felt that it no longer catered adequately to their needs and there was equal concern about the continuing lack of uniformity among the states. In 1936 the Merchants' Association of New York established a committee to prepare a federal Sales Act.⁶⁹ In its subsequent Report the committee recommended extensive changes in the Uniform Act. A bill was drafted and introduced in the Congress in 1940.

The step was strongly opposed at the state level and the sponsors of the bill agreed to defer further action until the NCCUSL could consider revising the *Uniform Sales Act*. Work on the project was begun. Since the National Conference had also sponsored over the years a large number of other commercial law acts, which appeared equally in need of revision, the thought commended itself to the Commissioners that all the uniform acts in this area should be reviewed and integrated as part of a much more ambitious project. Thus was born the concept of a Uniform Commercial Code.⁷⁰ In 1942 the prestigious American Law Institute agreed to co-sponsor the Code project and work was begun. The first "Official Draft" of the Code was published in 1952 and approved with

⁶⁴See, generally, McCurdy, "Some Differences between the English and the American Law of Sale of Goods" (1927), 9 Jl. Comp. Leg. & Int. Law, Series III, 15.

⁶⁵See, National Conference of Commissioners on Uniform State Laws, *Uniform Sales Act* (1906), s. 12.

⁶⁶See, *ibid.*, especially section 69.

⁶⁷*Ibid.*, ss. 27-40, as am. in 1922.

⁶⁸Gilmore, "On the Difficulties of Codifying Commercial Law" (1948), 57 Yale L.J. 1341, at p. 1342.

⁶⁹See, State of New York, *Report of the Law Revision Commission for 1955: Study of the Uniform Commercial Code*, Vol. I, p. (348) (hereinafter referred to as "NYLRC Study").

⁷⁰See, generally, Braucher, "Legislative History of the Uniform Commercial Code" (1958), 58 Col. L. Rev. 798.

minor changes by the sponsoring organizations. Pennsylvania was the first state to enact the Code and, since then, one or other version of the Code has been adopted by all the common law states and by the District of Columbia. Louisiana has adopted Articles 1, 3, 4 and 5 of the Code,⁷¹ but not Article 2, the Sales Article. The Code has been officially revised on a number of occasions, the most recent text being the 1972 Official Text.⁷² In an effort to avoid unauthorized changes and to maintain a watchful eye over developments, the sponsoring organizations established in 1961 a Permanent Editorial Committee. The Committee has issued a series of reports and was also responsible for the production of the 1972 Official Text. It has not, however, been entirely successful in its mission since, prior to the 1972 Official Text, a large number of unauthorized amendments had been made by individual states.⁷³

**(c) THE STRUCTURE OF THE UNIFORM COMMERCIAL CODE AND
SOME GENERAL CONSIDERATIONS**

The 1972 Official Text is divided into eleven major parts, or Articles as they are called. Each Article deals with a separate area of substantive law, with the exceptions of Article 1, which deals with General Provisions, and Articles 10 and 11, which are concerned respectively with Effective Date and Transitional Provisions. The intervening Articles are devoted to the following topics:

Article 2: Sales

Article 3: Commercial Paper

Article 4: Bank Deposits and Collections

Article 5: Letters of Credit

Article 6: Bulk Transfers

Article 7: Warehouse Receipts, Bills of Lading and other Documents of Title

Article 8: Investment Securities

Article 9: Secured Transactions, and Sale of Accounts and Chattel Paper

It will be seen, therefore, that despite its ambitious title the Code is not exhaustive: it does not include such important branches of commercial law as insurance law or agency, and it omits an equally extensive list of subjects falling within the jurisdiction of the American federal government. The unifying thread, it has been stated,⁷⁴ which binds together Articles 2

⁷¹La. Laws 1974, N. 92, effective 1/1/1975; Uniform Laws Annotated, *Uniform Commercial Code*, Cum. Ann. Pocket Part 1978, Table of Jurisdictions Wherein Code Has Been Accepted.

⁷²Unless otherwise indicated, all references in this Report are to the 1972 Official Text.

⁷³The amendments are noted in the Uniform Laws Annotated, Master Edition, of the *Uniform Commercial Code*.

⁷⁴*Uniform Commercial Code*, "General Comment of National Conference of Commissioners on Uniform State Laws and the American Law Institute", pp. xvi-xvii.

through 9 is the different phases in the movement of goods. Even this claim is not free of difficulty. Nevertheless, one can readily subscribe to the view that the Code is the most ambitious commercial law project ever undertaken in the Anglo-American legal world.⁷⁵ Equally impressive, from a Canadian point of view, is its universal acceptance among the common law states of the Union.

A question of some interest is whether the *Uniform Commercial Code* is a true code in the continental sense. Some observers have made this claim,⁷⁶ but it is rejected by other scholars who were closely associated with the Code project.⁷⁷ The claim is inconsistent with the Code's own provisions and the subsequent course of judicial developments. Admittedly, the Code has a substantial number of the characteristics usually associated with a code in the civilian sense:⁷⁸ it is systematic, comprehensive, and authoritative. But the *Uniform Commercial Code* is not self-sufficient. On the contrary, like the U.K. *Sale of Goods Act, 1893*⁷⁹ and *Bills of Exchange Act, 1882*,⁸⁰ and other codifying statutes of British origin, it relies on the general principles of law and equity to supplement its specific provisions and to fill its numerous gaps.⁸¹ There is equally little evidence, if indeed any, that the Code was intended to operate as an "undefined" source of new law,⁸² uncontaminated by what had preceded it, and serving as the exclusive repository of the solution to all future problems. Rather, the sign-posts point to a continuingly active role for judicial creativity in which the traditional techniques of lawmaking would be fully deployed within the bounds of a flexible system of *stare decisis*. The Code thus represents a higher plateau in the development of American commercial law, but many of the familiar features of the old landscape are still very much in evidence.

⁷⁵See, Mentschikoff, "Highlights of the Uniform Commercial Code" (1964), 27 Mod. L. Rev. 167.

⁷⁶For example, Hawkland, "Uniform Commercial 'Code' Methodology", [1962] U. Ill. L. Forum 291; Franklin, "On the Legal Method of the Uniform Commercial Code" (1951), 16 L. & Contemp. Prob. 330.

⁷⁷"It is fair to say that the draftsmen of the Code had an anticodification or anti-statute predilection": Kripke, "The Principles Underlying the Drafting of the Uniform Commercial Code", [1962] U. Ill. L. Forum 321, 331.

⁷⁸Compare, NYLRC Study, footnote 69 *supra*, Vol. I, p. (37).

⁷⁹56 & 57 Vict., c. 71 (U.K.), s. 61(2). For the equivalent Ontario provision see R.S.O. 1970, c. 421, s. 57(1).

⁸⁰45 & 46 Vict., c. 61 (U.K.), s. 97(2). For the equivalent federal Canadian enactment see the *Bills of Exchange Act*, R.S.C. 1970, c. B-5, s. 10.

⁸¹UCC 1-103. See, also, Summers, "General Equitable Principles under Section 1-103 of the Uniform Commercial Code" (in course of publication). Lord Herschell's judgment in *Bank of England v. Vagliano Bros.*, [1891] A.C. 107, (H.L.), at p. 145, is often cited for the proposition that in construing a codifying statute a court must first examine its language and determine its natural meaning, uninfluenced by any considerations derived from the previous state of the law. It is safe to say that, so far as the Sale of Goods Act is concerned, the canon has been more honoured in the breach than in its observance. The rule is even less meaningful in the Code context since many of the Official Comments to the sections extrapolate additional rules from the statutory text by repeated references to non-statutory principles or decisions.

⁸²The expression is borrowed from Professor Gilmore.

(d) ARTICLE 2⁸³

These remarks also apply to the sales article of the Code. As a learned scholar has observed,⁸⁴ while it was the pressure for a revised uniform sales act that launched the Code project, in the end it was Article 9 on Secured Transactions, and its innovative solutions to the chaotic state laws governing chattel security, that ultimately commended the adoption of the Code to many of the state legislatures.

This is not to suggest that Article 2 is merely a moderately amended version of the *Uniform Sales Act*. In style and organization it differs fundamentally from its predecessor, but the overall result is not a revolutionary blue-print for a new sales law. Rather, it meets two of the Code's own explicit objectives, "to simplify, clarify and modernize the law governing commercial transactions" and "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties".⁸⁵ The more important changes to the *Uniform Sales Act* effected by the Article are the following:⁸⁶

- (1) Article 2 is more extensive in its coverage. It contains a substantial number of sections⁸⁷ affecting the formation and construction of the contract of sale which have no counterpart in the *Uniform Sales Act* and which were designed to clarify or relieve the rigidities of the prior law. Article 2 also contains six sections⁸⁸ defining the meaning of shipping terms in use in domestic and international trade and also covering related matters.
- (2) The parties' freedom to shape the terms of their contract as they see fit remains a cardinal tenet,⁸⁹ but is qualified by important behavioural baselines in Articles 1 and 2 which cannot be excluded and which are designed to prevent overreaching and to ensure fairness and standards of decency in commercial dealings. Particularly noteworthy are the following: namely, the definition of "good faith" as applied to merchants in section 2-103; the court's power to police unconscionable terms or bargains incorporated in section 2-302; and, the restrictions on or avoidance of disclaimer clauses affecting products liability claims found in sections 2-318 and 2-719.
- (3) The Code's basic framework of the seller's warranty obligations⁹⁰ remains the same, but their scope is no longer restricted

⁸³The literature on Article 2, as on other Articles of the Code, is colossal. For a selected bibliography see Barnett & Perell (eds.), "Selected Bibliography on Sale of Goods (other than warranties) and Selected Aspects of General Contract Law", Research Paper No. I.5.

⁸⁴John Honnold, in Ziegel & Foster (eds.), *Aspects of Comparative Commercial Law* (1969), p. 4.

⁸⁵See, UCC 1-102(2).

⁸⁶Compare, NYLRC Study, footnote 69 *supra*, Vol. I, pp. (349) *et seq.*

⁸⁷For example, UCC 2-204 to 2-210, 2-305, 2-306.

⁸⁸UCC 2-319 to 2-324.

⁸⁹UCC 1-102(3). The same rule obtains in the Ontario Sale of Goods Act, R.S.O. 1970, c. 421, s. 53.

⁹⁰See, UCC 2-312 to 2-318.

by traditional doctrines of privity. As a result of the alternative versions of section 2-318, a seller's express or implied warranties extend to any person who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranty.

- (4) The concept of title and its location, which played such a critical role in the *Uniform Sales Act* (as it still does in the U.K. and Ontario Acts) in furnishing the answer to widely disparate problems, has been dethroned. It has been replaced by an issue oriented approach,⁹¹ which answers sale questions without regard to the locus of title.
- (5) The exceptions to the *nemo dat* rule have been enlarged,⁹² old and troublesome distinctions between void and voidable transactions have been eliminated,⁹³ and the protection of third parties dealing in good faith with a merchant to whom the goods have been entrusted has been placed on a more rational footing.⁹⁴
- (6) The importance of a merchant's status has also been enhanced in other directions by imposing upon him, in his capacity as buyer or seller, a higher regime of obligations than is applied to non-merchants.⁹⁵ However, this dichotomy between merchants and non-merchants is not nearly as significant as the more far-reaching distinctions between commercial and non-commercial sales known to many continental legal systems.
- (7) Article 2 places greater emphasis on the enforcement of bargains and discourages the rejection of goods based on trivial breaches or contrived excuses. Particularly noteworthy are the provisions on uncertainty (sections 2-204, 2-306), the right to cure an imperfect tender (section 2-508), and the substitutional methods of performance permitted in section 2-614 in the case of unforeseen difficulties.
- (8) At the remedial level, important changes have been introduced with respect to the scope and enforcement of the rights of both parties. Save in exceptional circumstances, the seller can no longer sue for the price before the buyer has accepted the goods.⁹⁶ On the other hand, the seller's right of stoppage *in transitu* is extended⁹⁷ and he may, at his option, where the buyer is in breach, resell the goods and recover any actual deficiency without being bound by the traditional market price test.⁹⁸ The unpaid seller is also given a limited right to recover

⁹¹See, UCC 2-401, 2-501, 2-509, 2-703, 2-709, 2-711, 2-716.

⁹²See, UCC 2-403.

⁹³See, UCC 2-403(1).

⁹⁴See, UCC 2-403(2).

⁹⁵See, for example, UCC 2-201(2), 2-205, 2-314, 2-509(3), 2-603, 2-605.

⁹⁶See, UCC 2-709.

⁹⁷See, UCC 2-705.

⁹⁸See, UCC 2-706.

his goods from an insolvent buyer.⁹⁹ The buyer, for his part, enjoys more extended powers to seek an order for specific performance,¹⁰⁰ and his right to "cover" in the event of the seller's failure to perform is the counterpart of the seller's right of resale.¹⁰¹ The conscious attempt to parallel the parties' rights is also seen in the retention of the *Uniform Sales Act* provision giving the buyer a lien on rejected goods in his possession¹⁰² and in his severely circumscribed right to recover goods identified to the contract where the seller has become insolvent after receiving all or part of the purchase price.¹⁰³ Finally, attention should be drawn to the important right conferred on both parties to seek adequate assurance of performance (section 2-609) where reasonable grounds for insecurity arise with respect to the other party's performance.

Most commentators welcomed these changes at the time they were first introduced and saw them as marked improvements over the prior law. Williston strongly dissented.¹⁰⁴ He regretted the iconoclastic approach to the *Uniform Sales Act* and was critical of some of the major changes. He did not feel that any advantages Article 2 might possess would offset the breach in the substantial uniformity in the sales law in most of the common law jurisdictions, both in and outside the U.S., that would result from its adoption. Many of Williston's misgivings have been proved unfounded by subsequent events.¹⁰⁵ On the whole, Article 2 has worked well. Although it has proved least successful in directing the growth of products liability law arising out of defectively manufactured goods, Article 2 appears to have spawned a relatively small number of important lawsuits, and only one major amendment has been found necessary since the adoption of the 1958 Official Text.¹⁰⁶ Williston's prediction was, however, accurate in one respect: Article 2 *has* broken the uniformity of basic sales law in the common law jurisdictions. However, non-American commentators¹⁰⁷ only see the breach as a reflection of the dated character of many of the provisions in the U.K. Act. Whether the breach can be healed and uniformity restored is a question that will be considered in a later section of this Report.¹⁰⁸

(e) UNIFORM LAND TRANSACTIONS ACT

In August, 1975, the National Conference of Commissioners on Uni-

⁹⁹See, UCC 2-702.

¹⁰⁰See, UCC 2-716.

¹⁰¹See, UCC 2-712.

¹⁰²See, UCC 2-711(3).

¹⁰³UCC 2-502.

¹⁰⁴Williston, "The Law of Sales in the Proposed Uniform Commercial Code" (1950), 63 Harv. L. Rev. 561. An article by Corbin supporting the proposed Code appeared soon after the publication of Williston's criticism: see, Corbin, "The Uniform Commercial Code — Sales: Should it be Enacted?" (1950), 59 Yale L.J. 821.

¹⁰⁵See, Honnold, in Ziegel and Foster, footnote 84 *supra*, at p. 5.

¹⁰⁶See, UCC 2-318.

¹⁰⁷See, for example, Sutton, "The Reform of the Law of Sales" (1969), 7 Alta. L. Rev. 130, at p. 173; Fridman, in Ziegel & Foster, footnote 84 *supra*, ch. 2; and Fridman, *Sale of Goods in Canada* (1973), ch. 13.

¹⁰⁸*Infra*, ch. 3, sec. 5.

form State Laws approved the *Uniform Land Transactions Act* and recommended it for enactment by the states.¹⁰⁹ The Uniform Act deals with contractual transfers of real estate, including transfers for security and transfers of limited interests, and purports to do for transactions in land what Articles 2 and 9 of the *Uniform Commercial Code* do in the realm of personal property. What is significant in the present context is the fact that the ULTA follows closely the structure and concepts of the corresponding provisions in the Code.¹¹⁰ This seems to indicate both the adaptability of the Code and a pervasive feeling that it is operating well and has not lost its essential relevance.

5. INTERNATIONAL DEVELOPMENTS

This survey of the evolution of modern sales law would be incomplete without some reference to developments at the international level. The need for uniformity in the law and practices governing international trading transactions has long been obvious. Since the war, increasing efforts have been mobilized at both the governmental and non-governmental levels to advance this objective.¹¹¹ As one of the world's major exporters and importers, Canada has an important stake in these developments. The legislative and other efforts to achieve international uniformity may also provide useful sources for national reforms and for uniformity within federal states, like Canada, where more than one legal system of private law obtains. The following organizational and legislative initiatives are of particular significance in the sales area.

(a) THE HAGUE CONVENTIONS OF 1964¹¹²

Formal efforts to draft a uniform law on international sales began in 1930 when the International Institute for the Unification of Private Law (UNIDROIT) appointed a committee for this purpose. In 1939 two reports accompanied by draft uniform laws were presented by the committee to the League of Nations. Work on the project was suspended until 1951 when, following a conference on the eve of the 7th Hague Conference of Private International Law, a Special Committee of Experts was appointed to resume the work of drafting. The committee presented its revised draft in 1956. At the same time a Committee of the Rome Institute was engaged in drafting a Uniform Law on the Formation of Contracts for International Sales. The two drafts formed the basis of an intensive conference at The Hague in 1964 and resulted in the adoption of two conventions, one on a Uniform Law on the International Sale of Goods¹¹³ and the other on a Uniform Law on the Formation of Contracts for the

¹⁰⁹Uniform Laws Annotated, Vol. 13, 1978 Pamphlet, pp. 47 *et seq.*

¹¹⁰*Ibid.*, pp. 47-48; and Miniter, "Annual Workshop on Commercial and Consumer Law, 1976: What Was Said" (1978), 2 C.B.L.J. 364, 392 *et seq.*

¹¹¹*Progressive Development in the Law of International Trade: Report by the Secretary-General*, UNCITRAL Yearbook, Vol. I, 1968-1970, pp. 18-45.

¹¹²The account which follows is based on Graveson, Cohn & Graveson, *The Uniform Laws on International Sales Act 1967* (1968), pp. 1-3. See also *passim*, Tunc, *Commentary of [sic] the Hague Conventions of 1st July 1964 on the International Sale of Goods and on the Formation of Contracts of Sale* (undated).

¹¹³Hereafter referred to as ULIS or the Uniform Law on Sales.

International Sale of Goods.¹¹⁴ To date the conventions have only been ratified or acceded to by nine, mainly smaller, countries.¹¹⁵ Canada and the U.S. are not among them. In view of the substantial criticism¹¹⁶ to which the Uniform Law on Sales has been exposed, and the revisionary work recently completed under the auspices of the United Nations Commission on International Trade Law (UNCITRAL), it seems unlikely that many more adoptions will materialize in the foreseeable future.

The Uniform Law on Formation is by far the shorter of the two Laws and comprises thirteen articles which, needless to say, do not exhaust the subject. Articles of particular interest include the following: namely, the dispensation with writing requirements (art. 3); the binding character of an irrevocable offer (art. 5); the time and form of acceptance (arts. 6, 8); the effect of additions, limitations or other modifications in the acceptance (art. 7); the effect of a late acceptance (art. 9); and, the validity of a revoked acceptance (art. 10). Some of these provisions may have been influenced by Article 2 of the *Uniform Commercial Code*.

The Uniform Law on Sales is much longer and runs to 101 articles.¹¹⁷ These are divided into six chapters which deal, respectively, with the Sphere of Application of the Law (ch. I), General Provisions (ch. II), Obligations of the Seller (ch. III), Obligations of the Buyer (ch. IV), Provisions Common to the Obligations of the Seller and the Buyer (ch. V), and Passing of the Risk (ch. VI). Despite its considerable length, the Uniform Law on Sales fails to deal with some important topics. It is not concerned with the substantive validity of the contract of sale or, with minor exceptions, with its property effects or the rights of third parties acquiring the goods from the party in possession. Questions of products liability not involving the buyer are also excluded. The parties' right to exclude or vary the provisions of the Uniform Law on Sales are recognized in article 3; however, unlike Article 2 of the *Uniform Commercial Code*, the Uniform Law provides no behavioural baselines to discourage unconscionable terms and to ensure reasonable standards of fair dealing. These omissions are no doubt due to the much more limited objectives of the Uniform Law.

In style and methodology the Uniform Law on Sales is more abstract and succinct than Article 2 and follows the civilian style of drafting rather than the common law tradition. Nevertheless, as in the case of the Uniform Law on Formation, some important resemblances to Article 2 can be detected in a number of provisions, examples of which are as follows: namely, the right to cure an imperfect tender (arts. 37 and 44); the right to suspend performance on grounds of insecurity (art. 73); and, the buyer's right to cover and the seller's right of resale and right to recover a deficiency (art. 85). Close similarities between the solutions adopted in the Uniform Law on Sales and those obtaining in the U.K. *Sale of Goods Act*,

¹¹⁴Hereafter referred to as ULFC or the Uniform Law on Formation.

¹¹⁵The nine countries are Belgium, Gambia, Israel, Italy, San Marino, the Netherlands, the U.K., the Vatican, and West Germany.

¹¹⁶See, for example, UNCITRAL Yearbook, Vol. I, 1968-70, pp. 159 *et seq.*

¹¹⁷The Law is reproduced in Graveson, footnote 112, *supra*.

1893 are evident in other areas.¹¹⁸ In many other respects the Uniform Law on Sales differs materially both from Article 2 and Anglo-Canadian sales law. Differences that have attracted unfavourable attention¹¹⁹ include the difficult definition of fundamental breach in article 10, the complex system of notices, and the concept of *ipso facto* avoidance.

(b) UNCITRAL

The United Nations Commission on International Trade Law was established by the General Assembly in 1966 with the object of promoting the progressive harmonization and unification of the law of international trade.¹²⁰ The Commission consists of 29 elected members of the United Nations who are drawn from the various geographical regions and principal economic and legal systems of the world.

The Commission meets annually, but the detailed work on individual projects is frequently delegated to small working groups. Since its creation the Commission has focused its activities on four major areas of international trade law: namely, international sale of goods; international payments; international commercial arbitration; and, international shipping legislation. Its principal project in the sale of goods area has been to review the Uniform Law on the International Sale of Goods. The purpose of this review has been to prepare a revised text that might render the Uniform Law more acceptable to countries of different legal, social and economic systems than the 1964 version. A working group was established in 1969 and completed its work in 1976.¹²¹ The draft Convention on the International Sale of Goods prepared by the Working Group was approved at a plenary session of the Commission in June, 1977.¹²² The Working Group has also subjected the Uniform Law on Formation to a similar review and completed this phase of its work in 1977.¹²³ At its Eleventh Session, held from May 30 to June 14, 1978, the Commission decided to integrate the draft Convention on Formation with the draft Convention on the International Sale of Goods, and adopted a single draft Convention on Contracts for the International Sale of Goods.¹²⁴ It is anticipated that the

¹¹⁸See, Szakats, "The Influence of Common Law Principles on the Uniform Law on the International Sale of Goods" (1966), 15 Int. & Comp. L.Q. 749, especially pp. 752 *et seq.*

¹¹⁹Compare, Honnold, "The Uniform Law for the International Sale of Goods: The Hague Conventions of 1964" (1965), 30 Law & Contemp. Prob. 326.

¹²⁰UNCITRAL Yearbook, Vol. I, 1968-1970, pp. 65-66. See also, Honnold (ed.), *Unification of the Law Governing International Sale of Goods* (Paris, 1966).

¹²¹Report of the Working Group on the International Sale of Goods on the Work of its Seventh Session, United Nations, General Assembly, A/CN. 9/116.

¹²²UNCITRAL, Report on Tenth Session (1977), General Assembly, Official Records: Thirty-Second Session, Supp. No. 17 (A/32/17), pp. 10 *et seq.* The Draft Convention is reproduced in Appendix 5 to this Report.

¹²³UNCITRAL, Report of the Working Group on The International Sale of Goods on the Work of its Ninth Session, A/CN. 9/42, Add. 1, 18 Nov., 1977.

¹²⁴UNCITRAL, Report on Eleventh Session (30 May-14 June, 1978), General Assembly, Official Records: Thirty-Third Session, Supp. No. 17 (A/33/17). The integrated document reached us too late for incorporation in the text of our Report and, unless otherwise indicated, all references are to the earlier draft Convention on Formation, footnote 123 *supra*, and draft Convention on the International Sale of Goods, footnote 122 *supra*.

integrated draft Convention will be submitted for approval in the near future at a diplomatic conference to be convened for this purpose.

The draft Convention on Sale follows the same structure as the Uniform Law, but it is substantially shorter and, in several respects, simpler.¹²⁵ The greater economy of the draft Convention is largely achieved by substituting for repetitive provisions in the Uniform Law,¹²⁶ an integrated regime of buyer's and seller's remedies for breach. Other significant differences are the adoption of a considerably simplified definition of fundamental breach¹²⁷ and the elimination of the concept of *ipso facto* avoidance.

(c) UNIDROIT

The role of the International Institute for the Unification of Private Law in Rome, in initiating and promoting the drafting of the Uniform Laws, has already been noted. The Institute has also been active in cognate areas of commercial law that have an important bearing on international sales law.¹²⁸ Work in progress or completed includes draft uniform laws on the Conditions of Validity of the Contract of Sale and on Agency of an International Character in the Sale and Purchase of Goods. Of particular interest is the draft Uniform Law on the Protection of the Bona Fide Purchaser of Corporeal Moveables, which was first published by the Institute in 1968 and subsequently revised in June, 1974.

(d) THE INTERNATIONAL CHAMBER OF COMMERCE

The Chamber, which enjoys consultative status under the charter of the United Nations, has long been active in promoting uniformity and greater harmonization in international trade terms and practices. In this regard, the Chamber has compiled interpretative and definitional manuals and standard conditions, which parties to international contracts are free to incorporate by reference in their agreements. Among the Chamber's better known publications are the *International Rules for the Interpretation of Trade Terms* (commonly referred to as INCOTERMS 1953) and the *Uniform Customs and Practice for Documentary Credits* (1974).¹²⁹ Both documents are widely used in international trading transactions.

(e) UNITED NATIONS ECONOMIC COMMISSION FOR EUROPE

Under the auspices of the Economic Commission for Europe, a wide variety of general conditions of sale and standard forms of contracts have been drafted by working parties for use in contracts for the supply of plant and machinery for export and import. The Commission has also sponsored model contracts for the sale of cereals, citrus fruit, sawn softwood, solid fuel, potatoes, and steel products.

¹²⁵The draft Convention comprises 68 articles compared with the Uniform Law's 101 articles.

¹²⁶Compare, draft Convention, arts. 27-34 and 43-47, with Uniform Law, arts. 24-32, 41-49, 61-64, 66 and 70.

¹²⁷Compare, draft Convention, art. 8, with Uniform Law art. 10.

¹²⁸UNIDROIT, [1974] Uniform Law Review 13, at pp. 15 *et seq.*

¹²⁹ICC Pub. No. 274 and Pub. No. 290.

CHAPTER 3

THE NEED FOR A REVISED SALE OF GOODS ACT: ITS FORM AND RELATED QUESTIONS

1. THE LAWYER'S VIEW

Commonwealth scholars have for a substantial time recognized important defects in *The Sale of Goods Act* and have urged amendments or adoption of a revised Act. The Sub-Committee of the Commercial Law Subsection of the Ontario Branch of the Canadian Bar Association, whose Report led to the establishment of the present Project, shared these sentiments,¹ as do the members of our Research Team. The Commission agrees with both these bodies. The defects in the existing Act can be fairly readily divided into two phases; namely, those defects that have existed from the beginning, and those defects that have emerged as a result of subsequent developments.

Among the original defects there may be included the following:

- (1) the unsatisfactory distinction between warranties and conditions and between contractual and non-contractual representations;
- (2) the artificial restrictions on the remedies of the buyer in a sale of specific goods under section 12(3), and the ambiguities about the scope and extent of the buyer's rights of examination and rejection under sections 33 and 34;
- (3) the conflict between sections 12(3), 29, and 33 and 34;
- (4) the need to show that a sale is a sale "by description" in order to render applicable the implied conditions of merchantability and fitness for purpose, and the ambiguities concerning the scope and interpretation of the implied warranties and conditions;
- (5) the conflict in wording and policy between sections 25(1) and 25(2);
- (6) overconceptualization of the significance of title and the consequences flowing therefrom;
- (7) ambiguity about the unpaid seller's resale rights with respect to goods in his possession, and unjustifiable restrictions on the buyer's right to obtain an order for specific performance; and,

¹In its Report, the Sub-Committee states, "The consensus of opinion of the Sub-Committee is that the present Sale of Goods Act of Ontario is not adequate to deal with today's commercial transactions and the problems arising in the course of such transactions. The Sub-Committee is of the opinion also that Article 2 should be enacted in the Province of Ontario firstly in order to remove the present inadequacy in the law and secondly in order to establish uniformity of sale of goods legislation with the United States in view of the magnitude of commercial transactions involving parties in Ontario and parties in states of the United States": See, *Report of the Sub-Committee on Article 2 to the Commercial Law Subsection, Ontario Branch, Canadian Bar Association*, appended hereto as Appendix 7.

- (8) the inadequate or, indeed, non-existent provisions concerning shipment and payment obligations, particularly with respect to imports and exports, and the failure to appreciate the importance of emerging credit transactions, both in their impact on payment methods, domestic and international, and with respect to the reservation of title.

Among the problems and issues generated by post-1893 developments, the following deserve particular emphasis:

- (1) the anomalous nature of the traditional distinction between sales and near-sales transactions in determining the parties' rights and obligations;
- (2) increasing dissatisfaction with basic contract doctrines, in particular those affecting:
 - (i) Statute of Frauds requirements;
 - (ii) the parol evidence rule;
 - (iii) the scope and role of consideration as a basis for the enforcement of promises and the modification of contractual rights;
 - (iv) the distinction between void and voidable mistakes and the consequences flowing from this distinction;
 - (v) the doctrine of certainty of terms as a prerequisite to the enforceability of bargains, particularly in the context of price; and,
 - (vi) the privity of contract rule, particularly in the context of manufacturers' express warranties.
- (3) the increasing disparity in bargaining power, not only between consumers and suppliers, but also between businessmen; the prevalence of standard form contracts and disclaimer clauses of various types; and, the frequency of the use of conflicting forms by sellers and buyers;
- (4) the revolution in manufacturing, distribution and retailing methods and in the quantity and kind of goods being manufactured that has occurred since the turn of the century, and the resulting need to come to grips with the scope and nature of a manufacturer's liability for defective goods to the ultimate user or purchaser, whether based on warranty concepts or under tort law;
- (5) the need for a clearer understanding of the basis of damage claims and the freedom of the parties to allocate losses arising from a breach of contract; and,
- (6) the need to review the *nemo dat* doctrine and the exceptions to it and to establish a modernized and integrated law of chattel security in conjunction with the establishment of an efficient central registry system.

2. BUSINESSMEN'S ATTITUDES

Although commercial lawyers would readily recognize the problem areas that we have identified, it must be admitted that there is little evidence that the business community feels equally keenly about the need for a revised Sale of Goods Act. There appears, rather, to be a fairly pervasive feeling that legal rules are not very relevant in the conduct of everyday business relationships,² and that such difficulties as may arise from time to time can be resolved amicably and without resort to the courts. This mood, which has been noted by other observers,³ emerges fairly clearly from several sources: namely, from the answers to several questions in the C.M.A. Questionnaire; from the paucity of litigation in the sales area;⁴ from the in-depth profile of selling and purchasing practices mentioned earlier;⁵ and, from the negligible response to both the questionnaire dealing with legal questions under *The Sale of Goods Act*, and the

²As one businessman observed in a letter to the Research Team, "While the Sale of Goods Act and pre-printed Terms of Purchase and Terms of Sale are doubtless of interest to lawyers, like most laymen, I feel that if much attention were paid to them in the real world, it would be impossible or impractical to efficiently buy or sell anything." On the other hand, the assistant general counsel of a major Canadian manufacturer of industrial and consumer durable goods told the Team that his company paid great attention to legal questions affecting the company's sale and purchase operations. Possibly the difference lies in the type of operation conducted by the company. A company that produces or sells a standard item may encounter few difficulties once the basic design and manufacturing problems have been overcome. A company manufacturing intricate and expensive items to specification, on the other hand, may be exposed to heavy damage claims if the product turns out to be defective or there is a delay in completion and delivery.

³See, for example, Macaulay, (1963), 28 Am. Soc. Rev. 55; and Macaulay, "Use and Non-use of Contracts in the Manufacturing Industry"; a panel (Macaulay, Kerwin, Diotte, Lungren, Baker, Nelson) (Nov. 1973), 9 Prac. Law 13, at p. 17.

⁴59.1% of the C.M.A. respondents claimed they never resorted to or became involved in litigation; 95.8% said they rarely became involved. If missing observations are treated as negative replies, 90.7% of the respondents were not involved in any kind of sales litigation in 1971, the year preceding the Questionnaire. The percentages were 92.2%, 94.4%, and 94.2% for the years 1970, 1969, and 1968 respectively. See, Fisher, Research Paper No. I.2, pp. 85-87; and, "The Canadian Manufacturers' Association Questionnaire and Statistical Results", Research Paper No. I.1, questions 91-92.

A survey conducted by James Murray, a student assistant to the Project, of sales litigation cases noted in *Canadian Current Law* for the years 1971-74 produced the following results:

<i>Parties:</i>	Consumer Actions	14)	42
	Industrial (business)	28)	
<i>Type of Goods:</i>	Industrial — Durable	20)	28
	Non-durable	8)	
	Consumer — Durable	11)	
	Non-durable	3)	14

These figures should be compared with the number of consumer complaints received by government departments and other agencies quoted in Chapter 1 of the Ontario Law Reform Commission's *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972).

⁵See, Munson, Research Paper No. I.3, at pp. 20-22.

advertisements soliciting suggestions with respect to desirable changes in the Act.

This apathy may be discouraging but it is not, we believe, a reliable guide to the need for a revised Act or the scope of its provisions. We base this view on a number of grounds. First, many of the C.M.A. respondents represent substantial and well-organized business establishments⁶ who are in a position to anticipate contractual conflicts and to resolve them by professionally drafted documents. Secondly, the paucity of litigation in the sales area is based on principles of reciprocity and the commendable desire of businessmen to resolve their differences amicably. It does not appear to be based on the certainty or adequacy of the existing law. Hence, little guidance is provided to the courts or to the parties' legal advisers where, for whatever reason, disputes proceed to trial.⁷ Thirdly, in several key areas, particularly those involving warranty and damage problems, there is a notable lack of consensus between buyers and suppliers as to the right solutions to be applied.⁸ Finally, the C.M.A. replies and the in-depth survey of selling and buying practices, show the wide gulf between the existing law and what many businessmen believe it to be; for example, with respect to the prerequisites of a binding contract.⁹

3. WHAT KIND OF REVISED ACT?

If the need for a revised Act is conceded, there arises the question of its form. There would appear to be three major alternatives:

- (1) to retain the essential structure and conceptual framework of the existing Sale of Goods Act and to amend the Act where necessary;
- (2) to adopt Article 2 of the *Uniform Commercial Code in toto* subject only to changes in drafting style to conform to Ontario usage; or,
- (3) to draft an entirely new Act which borrows heavily from Article 2 but is not simply a copy of it.

Each of these approaches has a number of advantages and disadvantages. So far as the first approach is concerned, amendment of the existing Act might facilitate continuing uniformity of the sales law of the Commonwealth countries and, further, might enable us to retain the benefit of the substantial body of jurisprudence that has accumulated to date. The disadvantage of an amended Sale of Goods Act is that, by the time all the

⁶Only 25.8% of the respondents had estimated annual sales of less than \$1 million. 3.4% of the respondents accounted for 50.1% of the categorized value of total sales: Fisher, footnote 4 *supra*, Table 1, p. 11.

⁷For some recent, illustrative, cases see *Beaver Specialty Ltd. v. Donald H. Bain Ltd.*, [1974] S.C.R. 903, (1974), 39 D.L.R. (3d) 574 (S.C.C.); *Canso Chemicals Ltd. v. Canadian Westinghouse Co. Ltd.* (1975), 54 D.L.R. (3d) 517 (N.S.C.A.); *Gilbert Steel Ltd. v. University Construction Ltd.* (1976), 12 O.R. (2d) 19, 67 D.L.R. (3d) 606 (C.A.), noted by Waddams in (1977), 2 C.B.L.J. 232; and *Cehave N.V. v. Bremer Handelgesellschaft m.b.H.*, [1976] 1 Q.B. 44 (C.A.).

⁸See, *infra*, chs. 9, 16, 17.

⁹*Infra*, ch. 5.

desirable changes have been made, little would remain of the original Act. It would, therefore, be illusory to call it an amended Act. Moreover, although uniformity remains a very desirable goal, the extent to which uniformity could be maintained among the principal Commonwealth countries is highly conjectural. In the commercial sphere, the U.K. appears to be leaning more heavily towards the Common Market countries than its Commonwealth partners, and this tendency is likely to be accentuated in the future. In any event, if uniformity is to be maintained, it would be better to secure it in the form of a commonly agreed revised Act than by continued reliance on a substantially obsolete Act.

The second approach, the integration of Article 2 into Ontario law, has some significant advantages. Article 2 is a carefully conceived law, flexible in nature, and sensitively attuned to the needs of an evolving commercial economy. It is in force in all the American states with the exception of Louisiana, and appears on the whole to be working very successfully. It has been used as the prototype for important parts of the *Uniform Land Transactions Act*. Article 2 has spawned a large exegetical literature, and Ontario lawyers would have the benefit of a readily accessible and growing volume of jurisprudence. The United States is also our closest trading partner¹⁰ and this, in itself, speaks for the desirability of a common sales law. Finally, Ontario has copied or been strongly influenced by other parts of the *Uniform Commercial Code*, namely Articles 8 and 9, and the adoption of Article 2 would therefore continue an existing trend.

There are, however, also disadvantages. Some important provisions in Article 2 are already dated; for example, the disclaimer provisions in section 2-316.¹¹ Further, the provisions in section 2-318 have been substantially superseded by subsequent tort law developments.¹² Moreover, the Statute of Frauds provisions, section 2-201, might well be regarded as obsolete¹³ and others, such as section 2-207, which deals with conflicting terms, have not worked particularly well.¹⁴ Some of the Code provisions may be regarded as too rigid, (for example, the perfect tender rule under section 2-601),¹⁵ or too radical, (for example, the seller's disentitlement to sue for the price except where the buyer has accepted the goods under section 2-709).¹⁶ Certain of the provisions may also be *ultra vires* the provinces, and others may be deemed inappropriate in an Ontario Sales

¹⁰Approximately two thirds of Canada's total external trade is conducted with the United States: *Canada Year Book*, 1976-77, para. 18.2.2. 41.6% of the CMA respondents reported doing some selling to the U.S.: see, Research Paper No. I.1, Q. 13c. It is also significant that 41.1% of the respondents were subsidiaries of American corporations: see Fisher, Research Paper No. I.2, p. 5.

¹¹*Infra*, ch. 9.

¹²*Infra*, ch. 10.

¹³*Infra*, ch. 5.

¹⁴*Ibid.*

¹⁵*Infra*, ch. 17.

¹⁶*Infra*, ch. 16.

Act.¹⁷ Finally, the Code's drafting style differs substantially from accepted Ontario usage.

In the light of the above considerations the Commission recommends the third alternative; that is, the adoption of an entirely new Sale of Goods Act which borrows heavily from Article 2 of the *Uniform Commercial Code* but is not simply a copy of this Article. We have thought it desirable to reflect our recommendations in legislative form, and have, accordingly, prepared a Draft Bill which we append to this Report.¹⁸ The pervasive influence of Article 2 may be discerned from a reading of this Draft Bill. Our approach has been to review Article 2 systematically and in great detail. In so doing, we have deleted, amended, or redrafted those provisions that we deem inappropriate or unnecessary in the Ontario context, or unacceptable on grounds of policy. We have also attempted to bridge the gap between the language of Article 2 and accepted Ontario legislative form. The dominant influence has been Article 2, but this has not been our exclusive source. In a number of important areas we have sought to produce a synthesis of the best features of the Code and of provisions in the existing Ontario and U.K. legislation, or, indeed, other sources.¹⁹ We have, however, made every attempt to avoid superimposing, in a mechanical way, Article 2 terminology, concepts and solutions on the differently worded and conceived Sale of Goods Act provisions; we were acutely aware that such a marriage might prove disastrous and give us the worst of both worlds.

Apart from stylistic changes, our Draft Bill differs from Article 2 in several significant respects, some of which may be briefly mentioned. The Draft Bill dispenses with writing requirements as a condition of the enforceability of a contract of sale.²⁰ It also abolishes, rather than modifies, the parol evidence rule.²¹ The Code's solution for dealing with conflicting writings, the "battle of the forms", has been substantially omitted.²² The Article 2 definition of good faith in the case of merchants has been extended to all buyers and sellers.²³ The Draft Bill adopts,²⁴ with changes, the definition of express warranty in section 12 of the *Uniform Sales Act* in preference to the test in UCC 2-313(1)(a), and substitutes a simpler régime²⁵ for Article 2's multiple provisions dealing with the effectiveness of disclaimer clauses. In this context, we would mention that the Draft Bill's definition of express warranty is wide enough²⁶ to permit direct

¹⁷Examples of the former type are UCC 2-502 and 2-702(2), discussed *infra* at chapters 17 and 16. Examples of the latter type are UCC 2-318 (seller's liability to third parties for defective goods) and UCC 2-725 (statute of limitations in contracts for sale).

¹⁸See, Appendix 1.

¹⁹See, for example, Draft Bill, ss. 5.10, 5.13. The principal sources of our draft provisions are indicated at the end of each section.

²⁰However, this does not preclude the parties from introducing their own writing requirements; for example, with respect to binding modifications of the contract: See, Draft Bill, s. 4.8(2).

²¹Draft Bill, s. 4.6.

²²*Infra*, ch. 5.

²³Draft Bill, s. 3.2 and 1.1(1)15.

²⁴Draft Bill, s. 5.10.

²⁵Draft Bill, ss. 5.16, 5.2(5).

²⁶Draft Bill, s. 5.10.

action against a manufacturer or other distributor for breach of an express warranty given by him to the ultimate buyer, whether or not there is priority of contract between the parties. The Bill does not, however, attempt to introduce a general regime of manufacturer's liability for defective products. Instead it confers²⁷ a form of subrogated right on a subsequent buyer for breach of warranty by a prior seller and leaves general products liability problems to be dealt with by other means.²⁸

The interrelationship between Article 2 and the Draft Bill deserves further comment. The provisions in Part VI of the Draft Bill dealing with the power of a seller, in stated circumstances, to confer a better title on his buyer than he himself has, are a synthesis of Article 2 and existing Ontario law, but go beyond both in several significant respects.²⁹ The Draft Bill rejects the perfect tender rule contained in Article 2 and the exceptions thereto. It adopts in their place a unified conceptual framework,³⁰ applicable to breaches by seller and buyer, in which the remedies turn on whether or not the breach amounts to a substantial breach of the contract.³¹ Finally, the Bill retains Article 2's concept³² of the seller's right to cure a breach where it is reasonable to allow him to do so, but expresses it in substantially different language.³³ The Draft Bill also departs from Article 2 in permitting an *aggrieved* seller or buyer, in defined circumstances, to demand cure from the party in default and to treat failure to cure as amounting to a substantial breach, whether or not the original breach could have been characterized in this manner.³⁴ The reasons for these and other departures will be explained in later parts of this Report.

4. AIDS TO INTERPRETING THE REVISED ACT

In view of the many differences between the existing Act and the Draft Bill that we are recommending for adoption, the Commission has given anxious consideration to the question whether the courts should be permitted to resort to extrinsic aids for the purpose of interpreting the proposed revised Act. We are evenly divided on the question. The present rule is³⁵ that, in general, the courts are not at liberty to go behind an Act for the purpose of construing its language and, in the view of some members of the Commission, this salutary principle should not be relaxed. The Commissioners who are of this opinion are concerned about creating a dangerous precedent, and about the impact that the admissibility of extrinsic evidence would have on the length of trials and the quality of statutory draftsmanship.

²⁷Draft Bill, s. 5.18.

²⁸*Infra*, ch. 10.

²⁹*Infra*, ch. 12.

³⁰Draft Bill, ss. 9.3, 9.12, 1.1(1)24.

³¹"Substantial breach" is defined in s. 1.1(1)24 of the Draft Bill.

³²See, UCC 2-508.

³³See, Draft Bill, s. 7.7.

³⁴Draft Bill, ss. 7.7(4) and (5), 9.4(1).

³⁵*Craies on Statute Law* (7th ed., 1971), pp. 128-31. The question has also been discussed on a number of recent occasions by the Uniform Law Conference of Canada: See, *Proceedings of 59th Annual Meeting* (August, 1977), pp. 30, 325, *et seq.*, and earlier reports referred to therein.

The other Commissioners believe that a modest relaxation of the rule can be amply justified in the present case. They support the insertion in the Draft Bill of a provision along the following lines:

In construing the provisions of this Act regard may be had to its legislative history and to any official report made to the Government or Legislature of Ontario.

It will be noted that this proposal falls markedly short of permitting the admission of every form of extrinsic aid. The argument in support of such a provision may be stated briefly. Should the Commission's recommendations be accepted, the close connection between Article 2 and the revised Act will be common knowledge. It would be anomalous if counsel, in arguing a point of construction of the revised Act, were permitted to refer to American sources but denied the opportunity to refer to the best possible evidence of the reasoning behind its many provisions.

As we have stated, the Commission is evenly divided on this issue and we therefore make no recommendation with respect to it one way or the other.

5. RETAINING UNIFORMITY WITH THE COMMON LAW PROVINCES

If additional evidence were needed, the C.M.A. results would clearly show³⁶ the importance of interprovincial sales for Ontario's economy. It would be unfortunate if the adoption of a revised Act were to create unintended impediments to the free flow of goods between the provinces. As has been previously noted,³⁷ the Uniform Law Conference has played an active role in sponsoring the drafting of uniform acts in other branches of commercial law, and we would urge its early involvement to explore the possibility of securing the adoption of a revised Uniform Sale of Goods Act.

6. GREATER HARMONIZATION BETWEEN THE LAWS OF ONTARIO AND QUEBEC

As the earlier resumé has shown, there are substantial differences between the sales law of Quebec and the sales law of Ontario. Some of the differences may be resolved as a result of the changes contemplated in the revised *Civil Code* and the changes in the Ontario law recommended in this Report. But significant differences are likely to remain, notwithstanding the revision of the domestic sales law in the two jurisdictions. Even under the most favourable conditions it would be unrealistic to aim for the total harmonization of the sales law of two provinces whose private law systems differ in fundamental respects. However, we see no harm and, indeed, potential good in consultations between the two governments with a view to determining how troublesome differences can

³⁶51.9% of the respondents have sales offices in other provinces, 65% purchase raw materials from other provinces, and 36.9% sell in excess of 40% of their goods to other provinces. Only 10.2% reported no sales in other provinces: See, Research Paper No. I.1, questions 9, 10, 11 and 13; Fisher, Research Paper No. I.2, pp. 4, 8, 9, 13.

³⁷Supra, ch. 2, p. 10.

best be resolved and greater harmonization secured in the applicable rules governing interprovincial sales transactions between their residents.³⁸

7. SHOULD ONTARIO ADOPT A COMMERCIAL CODE ALONG THE AMERICAN MODEL?

This question falls outside the strict terms of reference of the present Project, but is so intimately related to it that it warrants at least some preliminary observations. It is obvious that commercial law statutes such as *The Factors Act*,³⁹ *The Mercantile Law Amendment Act*,⁴⁰ and *The Warehouse Receipts Act*⁴¹ should be reviewed at an early opportunity with a view to updating them and ensuring their consistency with the revised Sale of Goods Act. However, this does not answer the wider question whether Ontario should aim for a Commercial Code along the American model.

We are not ready to commit ourselves to a firm view at this juncture, but we believe the question should be seriously considered upon completion of the revision of the Sale of Goods Act, if not indeed before. Several factors militate in favour of such a step. In the first place, Ontario has already been strongly influenced by two Articles of the *Uniform Commercial Code*, Articles 8 and 9.⁴² If the influence of Article 2 on the revised Sale of Goods Act is as substantial as this Report envisages, this number will be increased to three. Secondly, the law of documents of title in Ontario is in a state of considerable confusion and in need of clarification and modernization.⁴³ Article 7 of the *Uniform Commercial Code* might well serve as a prototype for the revision of this branch of commercial law. Finally, the existence of disparate commercial Acts, however admirable the Acts may be in their own right, always creates the danger of inconsistencies and overlapping in their treatment of common issues. To a considerable extent this problem already exists. The integration of the several Acts in a single Code would reduce this danger and make the law more accessible and, it is to be hoped, more certain.

It is appreciated that the subject matter of several important Articles in the *Uniform Commercial Code*, Articles 3, 4 and 5, falls in Canada primarily within federal jurisdiction. This suggests the desirability of a joint federal and provincial project in which the two levels of government would pool their constitutional powers to produce a harmonious body of commercial law. In our view such a venture would make good sense. Absent this cooperation, a "mini-Commercial Code" that would embrace the areas of sales, bulk sales, documents of title, investment sec-

³⁸The desirability of uniform legislation between Quebec and Ontario was also stressed in a letter to the Director of the Research Project by M. Emile Colas, c.r., a distinguished Montreal practitioner. M. Colas was responding to the Commission's news release announcing the Project.

³⁹R.S.O. 1970, c. 156 as am.

⁴⁰R.S.O. 1970, c. 272 as am.

⁴¹R.S.O. 1970, c. 489 as am.

⁴²See, *The Business Corporations Act*, R.S.O. 1970, c. 53 as am., ss. 63 *et seq.*, and *The Personal Property Security Act*, R.S.O. 1970, c. 344 as am.

⁴³See Baer, Research Paper No. IV.3.

urities, and secured transactions, would be a significant step in the progressive development of Ontario commercial law.

8. A LAW OF CONTRACT AMENDMENT ACT

Sales law is merely a specialized aspect of the law of contract; if the basic contract rules fail to keep abreast of changing needs, the quality of the sales law will also be affected. This was clearly recognized by the draftsmen of Article 2 who, as previously noted, introduced a substantial number of contract provisions designed to clarify or improve existing contract rules. It was for similar reasons that the Commission agreed that the list of matters to be researched should include papers⁴⁴ on the following topics: namely, the law of consideration; assignment of contracts and delegation of duties; mistake; contracts for the benefit of third parties; the law of anticipatory repudiation; and, frustration. The conclusions reached by the authors of these papers and by the Commission are referred to in later chapters in this Report.

It will be appreciated that the changes in the existing law recommended in these research papers, and, indeed, some of the changes recommended in other research papers, ought not to be confined to the revised Sale of Goods Act, but should be introduced generally in the law of contract. The Commission intends, once its work on the Sale of Goods Project is completed, to undertake a Law of Contract Amendment Project, which will examine those rules of general contract law that require reform. So far as the present Sales Project is concerned, we have incorporated in the Draft Bill changes in general contractual principles that have a particular bearing on sales law; where appropriate, similar changes will be incorporated in our proposed Law of Contract Amendment Act. Changes that are of only secondary importance in a sales context, or that require a fundamental recasting of basic contract doctrines, have been remitted exclusively to the proposed Law of Contract Amendment Act.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. Ontario should adopt a revised Sale of Goods Act that borrows heavily from Article 2 of the American *Uniform Commercial Code* but is not simply a copy of this Article.
2. The Uniform Law Conference of Canada should be asked to explore the possibility of a revised Uniform Sale of Goods Act.
3. Contact should also be established with the Quebec government with a view to promoting greater harmonization between the sales laws of Ontario and Quebec.
4. Related Ontario commercial legislation should be reviewed with a view to updating such legislation and ensuring its consistency with the revised Sale of Goods Act.

⁴⁴See Research Papers Nos. II.2, II.6, II.7, II.8, III.8 and III.8a, listed in Appendix 8.

5. The desirability of an Ontario Commercial Code should be considered.
6. As in the case of Article 2, desirable changes in general contract law that have a particular bearing on sales law should be incorporated in the revised Sale of Goods Act; other desirable changes in contract law should be remitted exclusively to a Law of Contract Amendment Act.

PART II

CHAPTER 4

SCOPE OF THE SALE OF GOODS ACT AND DEFINITION OF SALE

1. INTRODUCTION

The Sale of Goods Act applies only to transactions that are “contracts of sale”, as defined by the Act. Section 2(1) of *The Sale of Goods Act* defines a “contract¹ of sale of goods” as “a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration called the price”. “Seller”, “property”, “goods”, and “buyer” are separately defined in section 1. As might be expected, these definitions have spawned a generous quota of litigation. In particular, the courts have experienced difficulty in distinguishing between contracts of sale of goods and related types of transactions.

Many of the earlier cases were concerned with the applicability to the contract in question of the evidentiary requirements in section 17 of the *Statute of Frauds, 1677*,² now section 5 of the Ontario Act.³ Later in this Report we recommend elimination of this section in the revised Act and, to this extent, if our recommendation is adopted, one may anticipate a modest abatement in the case law turning on the distinction between contracts of sale and near-sale type transactions. In other areas, the courts have bridged the gap by assimilating sales and non-sales rules, wholly or in part, and this healthy movement may be expected to continue. But even after allowing for these developments, the distinction between sales and non-sales transactions remains important and therefore requires examination.

¹The *Uniform Commercial Code* distinguishes between an “agreement” and a “contract”. An “agreement” is defined *inter alia* as “the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act” [UCC 1-201(3)]. “Contract” is defined as meaning “the total legal obligation which results from the parties’ agreement as affected by this Act and any other applicable rules of law” [UCC 1-201(11)]. The terminological distinction, though frequently not observed in practice, is juristically sound and we have followed it in the Draft Bill: see s. 1.1(1).

²229 Car. 2, c. 3 (part) (U.K.), as amended by 9 Geo. 4, c. 14 (U.K.), s. 7.

³Section 5 of *The Sale of Goods Act* provides:

5.-(1) A contract for the sale of goods of the value of \$40 or more is not enforceable by action unless the buyer accepts part of the goods so sold and actually receives them, or gives something in earnest to bind the contract or in part payment, or unless some note or memorandum in writing of the contract is made and signed by the party to be charged or his agent in that behalf.

(2) This section applies to every such contract notwithstanding that the goods may be intended to be delivered at some future time, or may not at the time of the contract be actually made, procured, or provided, or fit or ready for delivery, or some act may be requisite for the making or completing thereof, or rendering them fit for delivery.

(3) There is an acceptance of goods within the meaning of this section when the buyer does any act in relation to the goods that recognizes a pre-existing contract of sale, whether there is an acceptance in performance of the contract or not.

The present chapter focuses attention on four principal issues: namely, (1) the character of the parties to the agreement; (2) the character of the agreement; (3) the meaning of "goods"; and (4) the meaning of "price". A concluding section considers briefly whether the revised Act should deal specifically with near-sale transactions, or whether the Act should include a general provision encouraging the courts to apply the sales solution by analogy where the underlying issues are identical or similar in nature.

2. THE CHARACTER OF THE PARTIES TO THE AGREEMENT

In general, the Ontario Sale of Goods Act, like the common law upon which it is based, does not distinguish between different types of buyers and sellers. For most purposes, the same rules are applied without regard to the character of the parties or the commercial or non-commercial nature of the transaction. In this respect the common law differs significantly from such civil law systems as the German and the French or, indeed, from the law of Quebec, in which the characterization of a transaction as commercial or civil entails important procedural as well as substantive consequences.⁴ Like the common law, the present Act does attach significance to the character of the parties in one respect: namely, in the recognition of the concept of a merchant, in the sense of a person who sells goods in the course of his business. Merchants fall into a separate category, but only in the context of the implied conditions of fitness and merchantability.⁵ A question worthy of consideration is whether the distinction between merchants and non-merchants should be applied to other parts of sales law.

Article 2 has made a modest beginning in this direction. "Merchant" as defined in UCC 2-104 embraces three types of person: (a) a person who deals in goods of the kind involved in the transaction; (b) a person who by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction; or, (c) a person to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who, by his occupation, holds himself out as having such knowledge or skill.

The "merchant" concept is applied by Article 2 in three groups of situations.⁶ It applies, first of all, to all businesses, including professional persons and institutions such as universities, at various phases in the formation and readjustment of the sales contract.⁷ Secondly, it is applied in the more restricted sense of a person dealing in goods of the kind involved in the particular transaction, to determine the following questions: the applicability of the implied warranty of merchantability;⁸ the rights of creditors with respect to goods left in the hands of a merchant-seller;⁹

⁴See, NYLRC Study, ch. 2, footnote 69, *supra*, Pt. III, pp. (87) *et seq.*, especially ch. II.

⁵See, section 15.

⁶See, UCC 2-104, Comment 2.

⁷UCC 2-201(2), 2-205, 2-207(2) and 2-209(2).

⁸UCC 2-314.

⁹UCC 2-402(2).

and, the effect of entrusting possession of goods to a merchant who disposes of the goods in the ordinary course of business.¹⁰ Finally, in a third group of cases, the concept is applied to merchants who satisfy either the "goods" or the "practices" aspect of the definition of merchant. This third group includes the enlarged duty to act in good faith enshrined in UCC 2-103(1)(b); the merchant-buyer's duties with respect to rejected goods or goods not accepted under a sale on approval;¹¹ risk of loss in the absence of breach;¹² and, the parties' entitlement to adequate assurance of performance.¹³ It will be noted that, in general, the Code provisions do not establish separate merchant standards with respect to the performance of the parties' obligations or the remedies available to them in the event of a breach. The one important exception involves the higher standard of good faith conduct expected of a merchant.¹⁴

We support the Code's approach and have adopted it, with modifications, in the Draft Bill.¹⁵ We recognize that there may be borderline cases in which it may not be easy to determine whether or not a party is a merchant. However, this determination does not appear to have given rise to any appreciable problems in the Code jurisdictions, nor in the growing number of Ontario statutes in which the applicability of an Act or parts thereof turns on the character of the actors.¹⁶ In saying this we do not wish to be understood as favouring a pervasive distinction in the revised Act between merchant and non-merchant parties; and, even less, as favouring the adoption of a separate Act to govern sales by non-merchants. In our view, whether or not the distinction is to be applied in a particular context should turn on functional considerations, on the purpose of the rule in question, and on its practical impact on one or other category of person.¹⁷

A separate but related question to the merchant, non-merchant dichotomy is the treatment of consumer sales; that is, the sale by a merchant of goods intended by the buyer for his personal or family use or consumption. *The Sale of Goods Act* provides no separate rules to govern such cases. With one exception,¹⁸ the position is the same in Article 2. This does not, of course, mean that Ontario has no separate rules regulating various facets of consumer sales; it only means that the provisions have not been incorporated in *The Sale of Goods Act*. As we have previously noted, during the past decade Ontario, in common with most of the other

¹⁰UCC 2-403(2).

¹¹UCC 2-327(1)(c), 2-603 and 2-605.

¹²UCC 2-509.

¹³UCC 2-609.

¹⁴UCC 2-103(1)(b). See, further, *infra*, ch. 7.

¹⁵See, s. 1.1(1)18.

¹⁶See, for example, *The Consumer Protection Act*, R.S.O. 1970, c. 82 as am., s. 1(s), definition of "seller"; *The Factors Act*, R.S.O. 1970, c. 156, ss. 1(c) and 2; and, *The Personal Property Security Act*, R.S.O. 1970, c. 344 as am., s. 30.

¹⁷Problems of classification are common to many legal systems. For a recent discussion of some of the difficulties, see Hellner, "The Draft of a New Swedish Sale of Goods Act", in *Acta Universitatis Stockholmiensis Studia Juridica Stockholmiensia* 58 (1978), also published as part of *Scandinavian Studies in Law* (1978), at pp. 55 *et seq.*

¹⁸UCC 2-318.

provinces, has adopted a substantial volume of consumer protection legislation that modifies or repeals the rules that would otherwise apply under *The Sale of Goods Act* or at common law. The question that arises is whether these provisions should be enlarged and systematized and converted into a separate consumer sales act to govern all aspects of sales to consumers.

A persuasive case can be made in favour of such a step. However, our terms of reference are not specifically directed to this question and, while we have considerable sympathy for the concept of a separate consumer sales act, there appears to be no immediate need for legislation of this kind. There will be time enough to consider its desirability after the present Sale of Goods Act has been revised. In any event, in our view, if the concept of a separate consumer sales act is to be pursued, it should be treated as a separate matter.

3. THE CHARACTER OF THE AGREEMENT

(a) MEANING OF "GENERAL PROPERTY"

It has long been accepted as the essential earmark of a sale that the transaction must involve a transfer of the general property in the goods as distinct from a more limited interest, such as the special interest of a bailee. The definition of "property" in section 1(1)(i) of the present Sale of Goods Act confirms this position. Section 1(1)(i) provides that "property" means the general property in goods and not merely a special property". This definition creates two difficulties.¹⁹

In the first place, it is not clear whether the "general property" envisaged by the Act refers to the legal title, or whether a beneficial equitable title or its equivalent will suffice. The distinction is material in the context of a conditional sale agreement where the buyer purports to sell his "equity" in the goods. The question arises whether the transfer by the buyer of his interest is a transfer of the general property and therefore governed by *The Sale of Goods Act*. If the seller's retention of title under a conditional sale agreement is viewed merely as the reservation of a security interest — a question that we discuss below — the sale of the interest acquired by the buyer under the conditional sale should clearly fall within *The Sale of Goods Act*. Likewise, if the buyer disposes of the goods without disclosing the outstanding conditional sale agreement, he would, on this reasoning, be guilty of a breach of the implied warranty of freedom from encumbrances, but not of the implied condition of title. The problem is, however, complicated by the broad wording of section 13(a) of *The*

¹⁹Other difficulties, which we do not pause to examine here, arise because the present Act uses "property" in some sections and "title" in others. On this point see, generally, Battersby and Preston, "The Concepts of 'Property', 'Title' and 'Owner' used in the Sale of Goods Act 1893" (1972), 35 Mod. L. Rev. 268; and, see further *infra*, chapters 11 and 12 with respect to our recommendations on the relevance of title in resolving issues between seller and buyer, and the circumstances in which a non-owner should be able to transfer a better title to chattels than he himself has.

Sale of Goods Act,²⁰ and by the absence of authoritative interpretation of the meaning of encumbrance for the purposes of section 13(c) of the Act.²¹ There appear to be few, if any, cases in which this question has been directly discussed.²² However, there are a substantial number of cases²³ in which a person selling goods that were subject to a prior undisclosed conditional sale agreement has been held guilty of breach of the condition of title under section 13(a), or of an express provision in the contract to the same effect, and not simply of breach of the warranty of freedom from encumbrances under section 13(c). The inference, therefore, is that the "general property" envisaged in section 1(1)(i) must be of a legal character or, at any rate, that the interest of a conditional buyer, however it is characterized, is not the general property predicated by *The Sale of Goods Act*.

The distinction is of considerable significance under existing law, because breach of the condition of title permits the innocent purchaser to reject the goods and sue for the return of his payments,²⁴ whereas interference with his possessory rights only amounts to a breach of warranty and his remedy is limited to a claim in damages. The Commission's *Report on Consumer Warranties and Guarantees in the Sale of Goods* recommended the abolition of the distinction between warranties and conditions

²⁰Section 13 of *The Sale of Goods Act* provides:

13. In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is,

- (a) an implied condition on the part of the seller than [sic] in the case of a sale he has a right to sell the goods, and that in the case of an agreement to sell he will have a right to sell the goods at the time when the property is to pass;
- (b) an implied warranty that the buyer will have and enjoy quiet possession of the goods; and
- (c) an implied warranty that the goods will be free from any charge or encumbrance in favour of any third party, not declared or known to the buyer before or at the time when the contract is made.

On the meaning of "a right to sell the goods" in s. 13(a), see *Niblett v. Confectioners' Materials Co., Ltd.*, [1921] 3 K.B. 387 (C.A.), foll'd in *Egekvist Bakeries v. Tizel & Blinick*, [1950] 1 D.L.R. 585, aff'd [1950] 2 D.L.R. 592 (Ont. C.A.).

²¹See, *infra*, ch. 9, sec. 1.

²²In *R. v. Hemingway*, [1955] S.C.R. 712, 1 D.L.R. (2d) 34, the issue was whether the conditional buyer acquired any property interest for the purposes of an information charging him with obtaining goods under false pretences. The question was answered affirmatively, but the precise character of the buyer's interest was not spelled out. See also, *Delta Acceptance Corp. Ltd. v. Redman*, [1966] 2 O.R. 35, 55 D.L.R. (2d) 481 (Ont. C.A.), in which Laskin, J.A., in his dissenting judgment, analogizes the position of a conditional buyer with that of a mortgagor. Once again, however, the issue before the Court did not involve *The Sale of Goods Act*.

²³For example, *Sloan v. Empire Motors Ltd.* (1956), 3 D.L.R. (2d) 53 (B.C.C.A.); *Fisher v. Campbell* (1960), 25 D.L.R. (2d) 774 (B.C.C.A.); and, *McNeill v. Assoc. Car Markets Ltd.* (1962), 35 D.L.R. (2d) 581 (B.C.C.A.). For the position in England with respect to hire-purchase agreements, see *Karflex Ltd. v. Poole*, [1933] 2 K.B. 251 and *Warman v. Southern Counties Car Finance Corp. Ltd.*, [1949] 2 K.B. 576.

²⁴*Rowland v. Divall*, [1923] 2 K.B. 500 (C.A.).

for the purpose of consumer sales,²⁵ and a similar recommendation is made in chapter 6 of the present Report with respect to other sales. If these recommendations are implemented, it may no longer matter whether the breach involves a breach of the implied term of title or a breach of the implied terms of quiet possession or freedom from encumbrances.

Nevertheless, we think it desirable to clarify the nature of a conditional buyer's interest for other purposes and, in so doing, we have followed the route of Article 2. Accordingly, in the Draft Bill, a "contract of sale" is no longer defined in terms of general property. Rather, following the example of UCC 2-106, "contract of sale" is defined to mean "a contract whereby the seller transfers or agrees to transfer the title in goods to the buyer for a price . . .".²⁶ "Title" is not defined. However, as in UCC 2-401,²⁷ the Draft Bill also provides, in dealing with the time and manner of passing of title, that "any reservation by the seller of the title in goods shipped or delivered to the buyer is limited to the reservation of a security interest".²⁸ It seems to us that this, in conjunction with the general effect of *The Personal Property Security Act*, should be sufficient to make it clear that the buyer in a conditional sale agreement acquires the beneficial title in the goods and should be in a position to transfer it to others, subject to the seller's security interest, and subject also to the effect of any restrictions in the original security agreement on the transfer of the buyer's interest.²⁹

There is a second difficulty arising from the definition of "contract of sale" in section 2(1) of *The Sale of Goods Act*. The requirement, imposed by the combined operation of sections 2(1) and 1(1)(i) of the Act, that the seller must agree to transfer the general property in goods, invites the inference that an agreement that merely transfers the seller's interest in the goods, whatever its quality, or that successfully excludes the implied condition of title, is not a "sale" within the meaning of the Act. Although this is a logical conclusion, it is opposed both to the common law history of the condition of title and to the wording of section 13.³⁰ The latter section clearly envisages the possibility that the seller may successfully exclude his title obligations, and where he has done so he can no longer be said to have agreed to transfer the general property in the goods: his commitment is limited to transferring the title if, in fact, he has title. The point is a fine one, but it has caused controversy among commentators.³¹

²⁵Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), p. 44.

²⁶See, section 1.1(1)8.

²⁷UCC 2-401(1), 2nd sent. See also UCC 2-505, which particularizes the general rule in the case of documents of title issued in the seller's name.

²⁸See, section 6.1(2)(b), and compare section 5.12(1)(b). "Security interest" is defined in section 1.1(1) 21 as "an interest in personal property, including goods, that secures payment or performance of an obligation".

²⁹Compare, *The Personal Property Security Act*, R.S.O. 1970, c. 344 as am., s. 33.

³⁰Supra, footnote 20. See further *infra*, ch. 9, sec. 1, and compare, Fridman, *Sale of Goods in Canada* (1973), pp. 109-10, and Greig, *Sale of Goods* (1974), pp. 15-16.

³¹See, for example, Hudson, "The Condition as to Title in Sale of Goods" (1957), 20 Mod. L. Rev. 236, and Reynolds, "Warranty, Condition and Fundamental Term" (1963), 79 L.Q. Rev. 534, 542.

We therefore think it desirable to make it clear that the type of transaction here discussed is a "sale" within the meaning of *The Sale of Goods Act*. We have sought to accomplish this objective by defining "contract of sale" in the Draft Bill to include contracts to which the provisions on the implied warranty of qualified title and the permissibility of disclaimer clauses apply.³²

(b) SALE INCIDENTS IN CONDITIONAL SALE AGREEMENTS

A conditional sale agreement involves a present transfer of possession to the buyer, but a retention of title by the seller by way of security until the purchase price is paid. It should be distinguished from a transfer of title in goods by way of security only; that is, a chattel mortgage. It has long been settled that such a transfer is not a sale, and this position is confirmed in section 57(3) of *The Sale of Goods Act*.³³

A conditional sale agreement may be characterized in one of two ways. Under the first characterization, it is viewed as an executory agreement of sale and thus would clearly fall within the description of an agreement to sell in section 2(3) of *The Sale of Goods Act*. According to the second characterization, upon delivery of the goods to the buyer there is a completed sale in all respects and the buyer has a legal interest in the goods which ripens into unencumbered ownership upon completion of his payments.³⁴ In the meantime the seller retains title, but only by way of security. The transaction is deemed to have the same effect as if there had been an outright transfer of title to the buyer, followed by a retransfer to the seller to provide him with his security; in other words, a short form of chattel mortgage. Once again, therefore, there should be no doubt that the sale incidents of the agreement are governed by *The Sale of Goods Act*.

Canadian jurisprudence has long been divided between these two characterizations,³⁵ with the majority of courts favouring the former. In Ontario, the uncertainty should be dispelled as a result of the adoption of *The Personal Property Security Act*, since the Act explicitly assimilates conditional sale agreements with other forms of chattel security agreements.³⁶ Under either characterization the great majority of Canadian courts have never shown much hesitation in applying the usual sales rules to regulate the sale incidents of the transaction. This observation is subject to two qualifications.

The first involves a number of early Ontario cases³⁷ in which the courts doubted whether a buyer under a conditional sale agreement, who

³²See, Draft Bill, s. 1.1(1)8.

³³Section 57(3) provides:

The provisions of this Act relating to contracts of sale do not apply to any transaction in the form of a contract of sale that is intended to operate by way of mortgage, pledge, charge or other security.

³⁴Compare, Vold, "The Divided Property Interest in Conditional Sales" (1930), 78 U. Pa. L. Rev. 713, and *Williston on Sales* (Rev. ed., 1948), sec. 330.

³⁵See, Goode and Ziegel, *Hire-Purchase and Conditional Sale* (1965), chapter 14.

³⁶See, *The Personal Property Security Act*, R.S.O. 1970, c. 344 as am., s. 2(a).

³⁷For example, *Frye v. Milligan* (1885), 10 O.R. 509 (H.C.J.); *Tomlinson v. Morris* (1886), 12 O.R. 311 (H.C.J.); *New Hamburg Mfg. Co. v. Webb* (1911), 23 O.L.R. 44 (H.C.J.).

had not yet paid the full price, was entitled to claim the usual measure of damages for breach of warranty. The courts were troubled by the thought that the buyer might lose the goods because of nonpayment, and held that the damage award should take this possibility into consideration. The short answer to this reasoning, surely, is that the possibility is too conjectural in character, and that it does not lie in the mouth of the defaulting seller to speculate about an event that has not occurred.

The second qualification may be found in the admittedly ambiguous judgment of Hall, J.A., in the decision of the Saskatchewan Court of Appeal in *Kozak v. Ford Motor Credit Co.*³⁸ This judgment leaves the inference that conditional sale agreements may be altogether excluded from *The Sale of Goods Act*. If this is a correct interpretation of the position of Hall, J.A., it is opposed by the great weight of earlier jurisprudence and would create numerous difficulties. Ontario's former Conditional Sales Act did not purport to regulate the sales aspects of a conditional sale agreement, and this is also the case under the present Personal Property Security Act. There does not appear to be any good reason why such statutes should intrude into sales law; indeed, section 17 of *The Personal Property Security Act* expressly provides the contrary.³⁹

Ill-founded though they may be, it seems desirable to resolve in the revised Act any doubts as to whether the sales incidents of a conditional sale agreement are governed by *The Sale of Goods Act*. Our Draft Bill, therefore, specifically includes within the definition of "contract of sale" a "contract in which the seller is to retain a security interest in the goods".⁴⁰ To place the matter beyond doubt, we have also inserted in the Draft Bill a provision to the effect that the Act shall not apply to any transaction which, whether or not it is in the form of an unconditional contract to sell or present sale, is intended to operate *only* as a secured transaction.⁴¹ The word "only" would make it clear that the sales incidents in a conditional sale agreement will be governed by the revised Sale of Goods Act.

(c) SALE OF A PART INTEREST

The concluding clause of section 2(1) of *The Sale of Goods Act* provides that "there may be a contract of sale between one part owner and another". In our opinion, this formulation is too narrow and does not adequately reflect either long established usage in the North American commodities trade, or commercial needs. The clause recognizes that a sale between co-owners falls within the Act, but fails to allude to the position involving the sale of a part interest, including the sale of a part interest

³⁸[1971] 3 W.W.R. 1, 18 D.L.R. (3d) 735 (Sask. C.A.). (Maguire, J.A., concurred with Hall, J.A.).

³⁹Section 17 of *The Personal Property Security Act* provides as follows:

- 17. Where a seller retains a purchase-money security interest in goods,
 - (a) *The Sale of Goods Act* governs the sale and any disclaimer, limitation or modification of the seller's conditions and warranties; and
 - (b) except as provided in section 16, the conditions and warranties in a sale agreement shall not be affected by any security agreement.

⁴⁰See, Draft Bill, s. 1.1(1)8(b).

⁴¹See, Draft Bill, s. 2.2(2).

in identified fungible goods, to a buyer who has no existing interest in the goods. The status of a contract for the sale of a specified quantity from a larger mass is of particular importance, since grain and other fungibles that are held in common storage for their owners by a warehouseman are sold daily "to an enormous amount".⁴² Nevertheless, the English rule still appears to be that no property in the goods passes to the buyer until they have been separated from the larger mass.⁴³ The Ontario position is unclear. However, in *Inglis v. Richardson*,⁴⁴ which was decided before Ontario adopted the U.K. *Sale of Goods Act, 1893*, the Appellate Division noted, without disapproval,⁴⁵ the Massachusetts and, indeed, majority American rule.⁴⁶ This rule holds that the parties, if they so intend, can create a tenancy in common with respect to the buyer's interest in the larger mass, and that prior severance is not essential.

This rule was adopted in section 6 of the *Uniform Sales Act* and has been reproduced in section 2-105(3) and (4) of the *Uniform Commercial Code* as follows:

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

"Fungible" is defined in section 1-201(17) of the Code as meaning, *inter alia*, goods "of which any unit is, by nature or usage of trade, the equivalent of any other like unit". We agree with Williston⁴⁷ that the English rule is anomalous, and we recommend the adoption in the revised Act of provisions comparable to those in the Code together with a definition of fungible goods.⁴⁸

(d) CONTRACTS OF SALE AND CONTRACTS FOR WORK AND MATERIALS

The distinction between these two types of contract is a familiar one and has been a fertile source of litigation.⁴⁹ The reason is that *The Sale of Goods Act* does not apply to a contract for work and materials. In speaking of such contracts, it is desirable to distinguish between two possible situations. Each situation includes elements of work and materials. In the first case, the labour and skill are incorporated in the production of the finished chattel. In the second, however, labour or services are provided *in addition* to materials, although they constitute part of the

⁴²See, *Williston on Sales* (Rev. ed., 1948), Vol. 1, sec. 155.

⁴³*Benjamin's Sale of Goods* (1974), para. 345.

⁴⁴(1913), 29 O.L.R. 229 (App. Div.).

⁴⁵*Ibid.*, at pp. 242-43.

⁴⁶On this point, see Williston, footnote 42 *supra*, secs. 155-57.

⁴⁷*Supra*, footnote 42, p. 403, sec. 150.

⁴⁸See, Draft Bill, ss. 1.1(1)14, and 2.4(4) and (5).

⁴⁹The case law is reviewed in Benjamin, footnote 43 *supra*, paras. 34-40, and by Samek, "Contracts for Work and Materials and the Concept of Sale" (1962), 36 A.L.J. 66.

same contract; the concept of incorporation is absent. In both types of case the question is one of characterization of the contract.

So far as the first type of contract is concerned, for example, a contract to paint a portrait, the contest is between a 'property' test on the one hand, and a 'relative value' or 'essential character' test on the other. The property test looks to see whether the contractor's labour and skill results in a completed chattel, the title in which is to pass to the buyer. If so, it is deemed to be a contract of sale. The relative value test measures the comparative worth of the materials and labour, and tilts the scale in favour of a contract for work and materials if the value of the labour clearly exceeds the value of the materials. This result has also been justified⁵⁰ by the so-called essential character or substance test. It is reasoned that what the customer bargains for in such cases is the skill and labour of the other contracting party, and that the supply of materials as part of the finished article is only incidental to the main purpose of the contract. It seems reasonable to assume that the definition of contract of sale in section 2 of *The Sale of Goods Act* reflects the property test as foreshadowed by the well-known judgment of Blackburn, J., in *Lee v. Griffin*.⁵¹ Unfortunately the English Court of Appeal reopened the question in *Robinson v. Graves*,⁵² and adopted what in effect amounts to a relative value test.⁵³

The case law is confusing, but the majority of the reported Canadian and English cases⁵⁴ appear to favour the Blackburn test. In our opinion, this is also the sounder test. The relative value test draws an arbitrary and untenable distinction between a contract for the purchase of finished goods and a contract for an article that is to be made to the buyer's order. The essential character test, insofar as it differs from the relative value test, is equally open to criticism because it overlooks the fact that "what passes to the client is not the materials but the finished [product], of which both the work and the materials are components".⁵⁵ *Robinson v. Graves* has left the law in an unsettled state. The Commission therefore recommends the adoption of a provision in the revised Act, similar in tenor to article 6 of the Uniform Law on Sales,⁵⁶ but made still more explicit. This provision should reaffirm that a contract of sale includes a contract for the supply of goods to be manufactured or produced by the seller, whether or not the goods are made specially to the buyer's order, and without regard to the relative value of the labour and materials involved.⁵⁷ It may be

⁵⁰See, *Robinson v. Graves*, [1935] 1 K.B. 579, 587.

⁵¹(1861), 1 B. & S. 272, 30 L.J. (Q.B.) 252.

⁵²*Supra*, footnote 50.

⁵³See Benjamin, footnote 43 *supra*, para. 40, p. 32.

⁵⁴For the English cases, see, *Benjamin's Sale of Goods* (1974), para. 40, n. 89; for the Canadian cases, see, for example, *The Canada Bank Note Engraving & Printing Co. v. The Toronto Railway Co.* (1895), 22 O.A.R. 462; *R. v. Haworth*, [1920] 2 W.W.R. 1043 (Sask. C.A.); *Ross v. Sadofsky*, [1943] 1 D.L.R. 334 (N.S.S.C.).

⁵⁵See, Benjamin, *supra*, para. 40, p. 32.

⁵⁶Article 6 provides as follows:

Contracts for the supply of goods to be manufactured or produced shall be considered to be sales within the meaning of the present Law, unless the party who orders the goods undertakes to supply an essential and substantial part of the materials necessary for such manufacture or production.

⁵⁷See, Draft Bill, s. 1.1(1)8(a).

thought that this formulation is not apt to describe a contract to paint a portrait, or to produce other articles of a highly personalized nature, and that such contracts are not normally described as contracts for the "manufacture" or "production" of "goods". We do not believe that there is any substance to this objection. As high a degree of skill enters into the production of many modern engineering products as into the painting of a portrait, and there has never been much hesitation in characterizing them as contracts of sale. The difficulty disappears once it is appreciated that *The Sale of Goods Act* is concerned with the transfer of title to goods of every description and not merely those of a commercial nature.

The second type of contract for work and materials presents greater difficulties. A typical example is a contract for the repair of a vehicle in which both labour and the replacement of parts are involved. Since labour is supplied in addition to the materials, *prima facie* the contract appears to be one of work and materials. It is not clear from the decisional law to what extent the relative value test is relevant in such circumstances. Most of the cases in which the contract has been characterized as one of work and materials⁵⁸ involved a substantial element of work, although apparently no attempt was made to quantify the relative value of the work and materials involved.

With one exception, neither *The Sale of Goods Act* nor Article 2 has attempted to change the common law position. UCC 2-314(1) provides that "Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale". This provision was inserted in order to lay to rest the divided American case law concerning a restauranteur's liability for the supply of food unfit for consumption. Its restrictive terms have created difficulties, which were apparently unintended by the draftsmen, and have encouraged some courts to deny warranty protection in blood transfusion and similar medical cases on the ground that no sale was involved.⁵⁹ As a result, the American position is again unsettled and it would not be wise, in our opinion, to copy the "food and drink" clause.

In considering the desirable response of the revised Act to this problem, two points need to be borne in mind. The first is that it is now settled law that a person supplying goods under a contract of work and materials in the context now discussed is strictly liable for the merchantability or fitness of the goods supplied by him, even though there has been no want of care or skill on his part in procuring the goods.⁶⁰ The second, and less clear, point is that, so far as the labour component is concerned, such a contractor is apparently only held to a standard of reasonable care and skill with respect to his own workmanship.⁶¹

⁵⁸For example, *G. H. Myers & Co. v. Brent Cross Service Co.*, [1934] 1 K.B. 46; *Dodd & Dodd v. Wilson*, [1946] 2 All E.R. 691 (K.B.); *De Palma v. Runnymede Iron & Steel Co.*, [1949] O.W.N. 262 (H.C.J.), aff'd [1950] O.R. 1 (C.A.).

⁵⁹See, for example, *Perlmutter v. Beth David Hospital* (1954), 123 N.E. 2d 792 (N.Y.C.A.). See, further, Honnold, *Cases and Materials on the Law of Sales and Sales Financing* (4th ed., 1976), pp. 145-46.

⁶⁰*Young & Marten Ltd. v. McManus Childs Ltd.*, [1969] 1 A.C. 454 (H.L.).

⁶¹*Halsbury's Laws of England* (4th ed., 1974), Vol. 2, para. 1568; Sutton, *The Law of Sale of Goods in Australia and New Zealand* (2d ed., 1974), 39.

On the face of it, it seems anomalous that two standards of responsibility should be applied to different components of the same contract. The anomaly becomes particularly evident when it is borne in mind that human skill is just as much involved in the production of a chattel as it is in a contract of work and materials.⁶² We do not, however, feel called upon to justify the distinction. It is sufficient to point out that, if the existing law is to be changed with respect to the scope of the implied warranty of care and skill in a contract for services or the labour component in a contract for work and materials, the change should be effected consistently across what would involve an enormous range of activities. Such an ambitious task falls quite outside our terms of reference.

We are therefore left with several alternatives. One is to continue to leave this type of contract to common law development and to say nothing about it in the revised Act. A second is to endorse the course of judicial development and to provide that in a contract of work and materials the contractor shall be subject to the same implied warranties with respect to the materials component of the contract as if he had sold the materials separately. Such an approach would leave the labour component free for further judicial development. A third possibility would be to single out particular contracts for special treatment as has been done in UCC 2-314. The Commission sees little merit in this last approach and, as has been noted, it could encourage false inferences. We therefore favour the second solution, and our Draft Bill contains a section to this effect.⁶³ We do so because of the frequency of contracts for work and materials, and the importance of establishing a clear chain of liability between the ultimate consumer and the person actually responsible for the defective product.

(e) AGENCY CONTRACTS FOR SALE, CONSIGNMENT CONTRACTS, AND CONTRACTS OF SALE OR RETURN

These types of contract present issues very different from those discussed in the previous section. An agency contract for sale involves goods entrusted to a person for sale on the owner's behalf; clearly, therefore, there is no contract of sale between the parties. A contract of sale or return, on the other hand, confers on the recipient an option to retain or return the goods, and hence the bailment may ripen into a sale. "Consignment contract" is not a term of art and may describe either an agency contract or a contract of sale or return.⁶⁴ *The Sale of Goods Act* touches only lightly on contracts of sale or return;⁶⁵ Article 2 is a little more

⁶²In *Young & Marten Ltd. v. McManus Childs Ltd.*, footnote 60 *supra*, the contractor's strict liability for defective materials was justified on the ground that, if the customer had no right of recourse against the contractor, he would be left remediless since there was no privity between the customer and the person from whom the contractor purchased the materials. The contractor, on the other hand, could seek his indemnity from the supplier based on breach of the latter's implied warranties.

⁶³See, Draft Bill, s. 5.15(2).

⁶⁴Compare, UCC 2-326(3).

⁶⁵See, s. 19, Rule 4.

expansive in its treatment⁶⁶ and we have preferred to follow the Code route in our Draft Bill.⁶⁷

However, it is not the absence of statutory detail that creates the difficult problems in practice. These are twofold and interrelated. The first is the difficulty of predicting whether a court will construe a particular agreement as being an agency contract for sale or a contract of sale or return, a difficulty that is illustrated by such cases as *Weiner v. Harris*,⁶⁸ *Weiner v. Gill*,⁶⁹ and *Langley v. Kahnert*.⁷⁰ There is no obvious answer to this problem and we offer no cure. The second difficulty arises because the rights of third parties, dealing in good faith with the person to whom the goods have been entrusted, may vary under the existing law depending on how the contract of entrustment is characterized. This problem is susceptible of cure, and is discussed in chapter 12 of this Report dealing with the *nemo dat* doctrine. There the conclusion is reached that, to the extent that external appearances are the same, a common set of rules should be applied. It should be noted, however, that the adoption of this recommendation will not change the inherent character of agency contracts of sale, or contracts of sale or return; nor will it make these contracts subject to sales rules that would not otherwise be applied.

(f) CONTRACTS OF BAILMENT, EQUIPMENT LEASES AND HIRE-PURCHASE AGREEMENTS

For a variety of reasons, the congeries of agreements generically described as chattel leases or equipment leases have grown very rapidly in importance since World War II and, predictably, some troublesome legal problems have emerged.⁷¹ Three questions predominate. The first is to determine how genuine equipment leases are to be distinguished from disguised conditional sales. The second is to what extent the implied warranties in the revised Sale of Goods Act, or some of them, should be extended to include true chattel leases. The third question involves the measurement of damages where the lessee has breached his agreement and the lessor has repossessed the equipment.

We begin with the issue of characterization. To appreciate the extent to which equipment leases may only be disguised conditional sales, it is necessary to distinguish between the following types of agreement:

(1) Agreements in which the lessor or owner contracts that, if the

⁶⁶See, UCC 2-326, 2-327.

⁶⁷See, Draft Bill s. 5.26.

⁶⁸[1910] 1 K.B. 285.

⁶⁹[1906] 2 K.B. 574 (C.A.), affirming [1905] 2 K.B. 172.

⁷⁰(1905), 36 S.C.R. 397.

⁷¹The literature is voluminous. See, *inter alia*, Coogan, "Leases of Equipment and Some Other Unconventional Security Devices: An Analysis of UCC Section 1-201(37) and Article 9", [1937] Duke L.J. 909; Hawkland, "The Impact of the Uniform Commercial Code on Equipment Leasing", [1973] U. Ill. L. Forum 446; Leary, "Leasing and Other Techniques of Financing Equipment under the U.C.C." (1969), 42 Temple L.Q. 217; Peden, "The Treatment of Equipment Leases as Security Agreements under the Uniform Commercial Code" (1971), 13 Wm. & Mary L. Rev. 110; and, Goode and Ziegel, footnote 35 *supra*, especially ch. 14.

lessee pays a stipulated rent for a stated period, the chattel is to become the property of the lessee at the end of the rental period. In the alternative the agreement may provide that, at the end of the rental period, the lessor will transfer the property in the leased goods to the lessee or execute a bill of sale in the lessee's favour.

- (2) Agreements in which the lessee promises to pay a sum in rentals equivalent to the purchase price of the chattel and is given the option of becoming its owner at the end of the rental period, either on tendering the last instalment or on paying an additional sum of a nominal amount.
- (3) Agreements in which the lessee agrees to lease the chattel for a minimum period at a rental which in the aggregate is substantially equivalent to the purchase price. In addition, he is given the option to purchase the chattel at the end of the rental period for a sum based on the anticipated residual value of the chattel.
- (4) Agreements in which the basic rental is equivalent to the purchase price and in which, instead of an option to purchase, the lessee is given the option to renew the lease at a nominal rental that, in conjunction with the basic period, will exhaust the normal useful life of the chattel.
- (5) Agreements in which the maximum rental payments equal the purchase price and in which, as in the second type of agreement, the lessee has an option to purchase the goods for a nominal sum at the end of the rental period. In addition, the lessee has the right to terminate the agreement at any time without being required to pay an additional sum if he exercises the right.
- (6) Agreements in which the rental payments equal the purchase price and which, as in the second type of agreement, confer an option upon the hirer of becoming the owner upon paying the last instalment or tendering an additional sum of a nominal amount. However, unlike the second type of agreement, this type entitles the hirer to terminate the agreement at any time, subject to his paying a minimum amount "in respect of the use" of, or by way of compensation for the "depreciation" of, the chattel. This minimum sum may be a fixed proportion of the hire-purchase price such as one-third or two-thirds or it may be based on the unpaid balance of the hire-purchase price, for example, the difference between the hire-purchase price and the sum of the value of the goods at the termination of the contract and the instalments already paid.

The first and second types of agreement were common in North America and the United Kingdom in the second half of the last century; the third and fourth types reflect current usages in North America. The fifth was common in England at the beginning of this century, and the

last is the type of hire-purchase agreement in current use in the United Kingdom and other parts of the Commonwealth.

The key in determining which of these agreements amounts to a disguised conditional sale turns on whether one applies an intention or substantial character test, or whether one follows the obligation test adopted by the House of Lords in *Helby v. Matthews*.⁷² The difference between these tests may be stated in this way: the intention or substantial character test looks at the overall impact of the agreement and the intention of the parties as gathered from all the surrounding circumstances; the obligation test restricts itself to asking whether the lessee or hirer has *obligated* himself to pay the price and acquire the title to the goods, and ignores all other considerations. The majority of American courts have long favoured the intention or substantial character test. The English and other Commonwealth courts have generally followed the *Helby v. Matthews* test without much hesitation.⁷³

The intention test has now been formally enshrined in section 1-201 (37) of the *Uniform Commercial Code*.⁷⁴ There is no specific counterpart to the section in the Ontario Personal Property Security Act, but it seems reasonably safe to assume that the courts will import the intention test by necessary implication. In any event, the substantial character test adopted for *all* security agreements in section 2(a) of *The Personal Property Security Act*⁷⁵ will probably lead to the same result in most cases.

In our opinion, the intention or substantial character test is clearly to be preferred to the legal obligation test. We therefore recommend including in the revised Act an appropriate provision dealing with the scope of the Act, a provision which will dovetail with the provisions in

⁷²[1895] A.C. 471 (H.L.).

⁷³For some Canadian illustrations, see: *C.A.C. Leasing Co. v. Calce*, [1969] 2 O.R. 707, 6 D.L.R. (3d) 495 (Ont. C.A.); and, *Canadian Acceptance Corp. Ltd. v. Regent Park Butcher Shop Ltd.* (1969), 3 D.L.R. (3d) 304 (Man. C.A.). Note, however, that Interpretation Bulletin IT-233 (July 14, 1975) on the Canadian *Income Tax Act* adopts the intention or substantial purpose test.

⁷⁴UCC 1-201(37) provides in part:

Unless a lease or consignment is intended as security, reservation of title thereunder is not a 'security interest' but a consignment is in any event subject to the provisions on consignment sales (Section 2-326). Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

⁷⁵Section 2(a) provides:

Subject to subsection 1 of section 3, this Act applies,

(a) to every transaction without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest, including, without limiting the foregoing,

- (i) a chattel mortgage, conditional sale, equipment trust, floating charge, pledge, trust deed or trust receipt, and
- (ii) an assignment, lease or consignment intended as security.

*The Personal Property Security Act.*⁷⁶ The wording of UCC 1-201(37), however, leaves something to be desired. We think it sufficient simply to state that "Whether or not a contract in the form of a lease of goods, bailment, hire-purchase, consignment or otherwise is a contract of sale depends on the intention of the parties, the substantial effect of the contract and all the other surrounding circumstances". The courts can then be left free to develop more refined criteria in the light of the abundant case law and literature that is now available in this area. This approach seems preferable to a long shopping list and, as opposed to pre-determined criteria, will be easier to apply to changing conditions.

Apart from the characterization issue, two other issues involving true chattel leases deserve to be considered. The first concerns the desirability of extending the implied warranties in the revised Sale of Goods Act, or some of them, to include such leases.⁷⁷ We favour such a step because of the uncertainty that still surrounds the scope and content of the implied warranties in leasing agreements. However, it will be convenient to postpone further consideration of this question to a later part of this Report.⁷⁸

The other issue involves the measure of the lessor's damages where he terminates the lease because of a breach of the agreement by the lessee.⁷⁹ *Prima facie*, the measure of damages should be governed by normal contractual principles,⁸⁰ and the lessor should be entitled to recover, depending on the circumstances, his net loss of profit or the deficiency in the agreed rental payments, after allowing for the resale value of the repossessed chattel. Unfortunately, the position has been much complicated, both in England and Canada,⁸¹ by two judicial developments. The first is the striking down of liquidated damage clauses of all types on the ground that they are penal in character. The second difficulty stems from the English Court of Appeal's decision in *Financings Ltd. v. Baldock*.⁸² In that case it was held that failure by the lessee in a hire-purchase agreement to pay one or two instalments does not, by itself, amount to a repudiation of the agreement and that, in the absence of such a finding, the repossession lessor is only entitled to recover nominal damages. This course of judicial evolution leaves the lessor in an invidious position and at a serious disadvantage compared with the seller under a conditional sale.

⁷⁶See, Draft Bill, s. 2.2(3).

⁷⁷The implied warranties will automatically apply to security leases since the revised Act, following an earlier recommendation, will treat them as secured sales.

⁷⁸See, *infra*, ch. 9.

⁷⁹See, generally, Varcoe, "Finance Leasing — an Analysis of the Lessor's Rights upon Default by the Lessee" (1976), 1 C.B.L.J. 117; and, Ziegel, "The Minimum Payment Clause Muddle", [1964] Camb. L.J. 108.

⁸⁰*Interoffice Telephones v. Robt. Freeman Co. Ltd.*, [1958] 1 Q.B. 190 (C.A.).

⁸¹The English cases are reviewed in Goode, *Hire-Purchase Law and Practice* (2d ed.), ch. 18. A leading Canadian authority is *C.A.C. v. Regent Park Butcher Shop Ltd.* (1969), 3 D.L.R. (3d) 304 (Man. C.A.).

⁸²[1963] 2 Q.B. 104 (C.A.), foll'd in Canada, *inter alia*, in the *Regent Park* case, *supra*. The *Regent Park* decision was distinguished in *Security Leasing Co. Ltd. v. Balkan Restaurant Ltd.*, [1976] 5 W.W.R. 590 (B.C., Cashman, C.C.J.), but a higher court still has to rule on the soundness of the distinction.

A possible solution would be a statutory amendment assimilating the rights of a lessor to those of a conditional seller and, subject to proper safeguards, permitting the lessor after repossession and disposition of the repossessed goods to recover any deficiency in the lease price. Before its repeal, the Ontario Conditional Sales Act⁸³ had regulated from an early date the deficiency rights of conditional sellers. Similar provisions now appear in Part V of *The Personal Property Security Act*, which regulates the enforcement rights of all secured parties. Given these precedents and the close relationship between secured sales and many types of long term leases, it seems to us that *The Personal Property Security Act* would be a better place for this amendment than the revised Sale of Goods Act. In any event, we recommend that the question be referred for further study to the Advisory Committee on The Personal Property Security Act, a Committee that is currently reviewing the Act.

4. THE MEANING OF “GOODS”

Section 1(1)(g) of *The Sale of Goods Act* provides that “goods” means “all chattels personal, other than things in action and money, and includes emblements, industrial growing crops, and things attached to or forming part of the land that are agreed to be severed before sale or under the contract of sale”. The definition generally follows the pre-1893 case law, with the possible exception of the category of “things attached to or forming part of the land”. The latter part of the definition appears to be based on the doctrine of *Marshall v. Green*,⁸⁴ but may have enlarged it significantly, as will be seen presently.

The *Uniform Sales Act*⁸⁵ adopted the British (and therefore Ontario) definition of goods. However, this continuity has been broken in Article 2 of the *Uniform Commercial Code*, section 2-105(1) of which defines goods as follows:

(1) ‘Goods’ means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action. ‘Goods’ also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (Section 2-107).

If the case law is a reliable guide, the aspect of the definition of goods that creates the greatest difficulties involves the status of things attached to land. Before dealing with this important issue, several other elements in the Ontario and Code definitions should be noted briefly.

(a) “ALL CHATTELS PERSONAL”

The phrase “chattels personal” has a well established meaning at

⁸³R.S.O. 1970, c. 76, s. 9.

⁸⁴(1875), 1 C.P.D. 35.

⁸⁵Section 76.

common law,⁸⁶ but its usefulness as a definitional basis in a modern sales act is open to question. The term covers all forms of personal property and therefore includes intangibles (things in action) as well as tangibles (things in possession). Since things in action are expressly excluded from the statutory definition, goods are in fact equated with movables. It would appear to be simpler to define goods as "all movable things", as section 2-105(1) of the Code has done, and we so recommend.

If this recommendation is followed, for the sake of consistency, the definition of goods in *The Personal Property Security Act*⁸⁷ should be similarly amended, both on this point and with respect to the other points to be mentioned hereafter.

(b) "SPECIALLY MANUFACTURED GOODS"

As will have been noted, there is no specific reference to this category of goods in the Ontario definition of the term contained in section 1(1)(g). Prior to the enactment of the *Uniform Sales Act*, some American jurisdictions appear to have characterized contracts for the manufacture of individual goods as contracts of work and materials. The specific reference to "specially manufactured goods" in section 2-105(1) was presumably designed to reverse this classification. Whether this expression was intended, or is capable, of being applied to a wider range of contracts is not clear. As has been noted, the difficulty experienced by the Anglo-Canadian courts was not with respect to the category of goods as such. Rather, the problem was to determine whether contracts involving a dominant element of personal skill, such as contracts to create works of art, should be treated as contracts of sale. There would, therefore, not appear to be any necessity for introducing the American gloss in the revised Ontario Act.

(c) "THINGS IN ACTION"

Both section 1(1)(g) of *The Sale of Goods Act* and UCC 1-105(1) exclude "things in action" from the definition of goods. It appears to be well settled,⁸⁸ both at common law and under *The Sale of Goods Act*, that the term "things in action" covers all forms of incorporeal property. This would appear to be so whether or not the thing in action is evidenced by or incorporated in documents or instruments or other forms of writing, negotiable or otherwise; for example, share certificates, bonds, or bills of exchange. We do not believe it necessary to amplify the term "things in action" to make this clear. It may be noted that section 2-105(1) also expressly excludes "investment securities". Presumably, this exclusion was intended to reject pre-Code decisions treating shares of stock as goods, wares or merchandise under provisions similar to section 17 of

⁸⁶Colonial Bank v. Whinney (1885), 30 Ch. D. 261 (C.A.), especially *per* Fry, L.J., at pp. 285-86; and *ibid.* (1886), 11 A.C. 426 (H.L.), especially at pp. 434, 438-40.

⁸⁷R.S.O. 1970, c. 344, s. 1(k).

⁸⁸Vaines, *Personal Property* (5th ed.), pp. 262 *et seq.*; Benjamin, footnote 54 *supra*, para. 72.

the U.K. *Statute of Frauds*.⁸⁹ Since this construction was apparently never adopted in Anglo-Canadian law, we see no reason for adopting this feature of the Code definition.

(d) "MONEY"

Section 1(1)(g) of the Ontario Sale of Goods Act excludes "money" from the definition of "goods". It has, however, been held in Canada,⁹⁰ England,⁹¹ and the U.S.A.⁹² that money can be treated as goods when it is transferred as a commodity and not simply as a medium of exchange. The Code's definition of goods captures this distinction insofar as it excludes "the money in which the price is to be paid". The clarification is useful, and we accordingly recommend its adoption in the revised Ontario Act.

(e) "UNBORN YOUNG OF ANIMALS"

This category of goods is expressly embraced in section 2-105(1), but has no counterpart in *The Sale of Goods Act* or in the *Uniform Sales Act*. It is, however, recognized, at least for some purposes, in section 13(1) of *The Personal Property Security Act*. There appears to be a lack of direct authority dealing with the sale of the unborn young of animals. In principle, however, an attempt at common law to make a present but separate sale of animals conceived but not yet born should have been ineffectual: it was of the essence of the definition of tangible chattels personal that they should be capable of transfer by possession.⁹³ It is possible that, once the young were born, the animals would pass to the buyer at common law under the doctrine of potential possession without any further act of appropriation by the seller,⁹⁴ but the doctrine has no bearing on the question whether the unborn young of animals can acquire a separate legal existence.

The innovation in UCC 2-105(1) is not as far reaching as may appear at first sight. By virtue of section 2-501, it is true, the buyer obtains a special property and an insurable interest as soon as the young are conceived; however, in the case of a contract for their future sale, section 2-501(c) adds the restriction that the young must be conceived within twelve months of the contract. In either event, even after concep-

⁸⁹This explanation is not offered in Official Comment 1 to UCC 2-105, but is to be inferred from the discussion in Williston, footnote 42 *supra*, sec. 67. Note that section 4 of the *Uniform Sales Act* (the Statute of Frauds provision) expressly included choses in action. Compare, *Agar v. Orda* (1934), 190 N.E. 479, 99 A.L.R. 269 (N.Y.). Note, too, that UCC 1-206 contains various requirements with respect to contracts for the sale of personal property not elsewhere covered in the Code where the amount involved exceeds \$5000.

⁹⁰*R. v. Vanek*, [1969] 2 O.R. 724 (H.C.J.); *R. v. Behm* (1969), 12 D.L.R. (3d) 260 (Que. C.A.).

⁹¹*Moss v. Hancock*, [1899] 2 Q.B. 111, as interpreted in Benjamin, footnote 54 *supra*, para. 76.

⁹²Williston, footnote 42 *supra*, sec. 66b.

⁹³*Halsbury's Laws of England* (3rd ed., 1962), Vol. 29, para. 714, p. 359.

⁹⁴On this point, see Benjamin, footnote 54 *supra*, para. 98; Williston, footnote 42 *supra*, secs. 133 *et seq.*; and, Fridman, *Sale of Goods in Canada* (1973), p. 46. The doctrine has not been adopted in *The Sale of Goods Act*.

tion, the risk of loss *prima facie* remains with the seller until, depending on the circumstances, the buyer has received "the goods" or there has been a tender of delivery.⁹⁵ These requirements clearly postulate the birth of the animals.

So far as the buyer's position vis-à-vis third parties is concerned, this will depend upon the construction of another group of Code provisions, whose impact on this type of contract is not always clear. As a result of UCC 2-722(a), the buyer with a special property would appear to have a right to sue for actionable injury caused by a third party's dealing with the animals, but his right to sue in conversion would not arise unless the risk of loss had passed to the buyer. Further, his right to resist a seizure by the seller's creditors is very circumscribed,⁹⁶ and a wrongful resale by the seller to a buyer in ordinary course of business could also override the first buyer's prior interests by virtue of the "entrusting" doctrine in UCC 2-403(2).⁹⁷ Whether there can be an effective transfer of title to the buyer under the residuary provisions in UCC 2-401(3)(b), even before the young are born, is arguable, although a literal reading of the subsection would lead to this conclusion.

These provisions may need to be re-examined and clarified if Ontario decides to recognize the unborn young of animals as a separate category of goods in the revised Act. On balance we have decided that it is a desirable change, although its practical, or legal, importance should not be exaggerated. Accordingly, we recommend that the definition of "goods" in the revised Act should recognize the "unborn young of animals" as a separate category of goods. We base our recommendations on several grounds. In the first place, Ontario law already recognizes the possibility of a present sale of growing crops or other things attached to land, and in principle there appears to be no distinction between such a sale and the sale of unborn young. Secondly, there is no reason why, for example, the buyer of the offspring of a famous racing horse or prize bull should not be able to insure them even before birth; or, indeed, why he should not have a right of action against a third party who injures the unborn young. Thirdly, important changes are occurring in breeding practices (including, particularly, the introduction of embryonic transplant techniques), which may enhance the commercial importance of interests in the unborn young.

In our opinion, the enlarged definition of goods will not unfairly prejudice the rights of third parties. Under existing law, where a seller is left in possession of goods following their sale, he can, in certain circumstances, confer a better title on a purchaser than he himself has. As will be seen in chapter 12 of this Report, we propose retaining this rule in the revised Act, albeit with some qualifications. As a result, a buyer of the young of animals who has satisfied himself that there are no registered interests, under *The Personal Property Security Act*⁹⁸ or other

⁹⁵UCC 2-509(3).

⁹⁶UCC 2-402.

⁹⁷See, *infra*, ch. 12.

⁹⁸R.S.O. 1970, c. 344 as am.

relevant legislation, against the mother animal will not have to concern himself with any possible prior sales by the seller of which he is ignorant. In short, he will be in no different position from any other buyer of goods from a seller without title.

(f) GOODS AND LAND

We turn now to the most troublesome set of problems in connection with the definition of goods. The difficulties are compounded because of a conflict between the definition of goods in *The Sale of Goods Act* and the definition of land in the Ontario real property statutes.⁹⁹ The key issue is whether a contract for the sale of things attached to or forming part of the land, that are to be severed from the land under a contract, should be treated as a contract for the sale of goods or as a contract for the sale of an interest in land. In the discussion that follows, it will be convenient to distinguish between the Anglo-Canadian law and the approach to the same problems adopted in the *Uniform Commercial Code*.

(i) Anglo-Canadian Position¹⁰⁰

In general, the pre-1893 law drew a distinction between two types of contract: namely, contracts that required the seller to sever the things and deliver them to the buyer; and, those that authorized or required the buyer to do the severing and, for this purpose, created an interest in the land or conferred a licence upon the buyer to enter the land.¹⁰¹ If the contract fell into the former category, it was treated as a contract for the sale of goods and no interest in the things attached to or forming part of the land was deemed to pass to the buyer until they had been severed from the land and appropriated to the contract. If the contract was of the latter kind, it was treated as a contract for the sale of an interest in land and, subject to two exceptions, was therefore governed, *inter alia*, by section 4 of the English *Statute of Frauds*,¹⁰² which contained requirements as to formalities. Each of these exceptions involved the products of the soil and should be briefly noted.

The first exception concerned *fructus industriaes*, which has been defined as "fruits or crops produced 'in the year, by the labour of the year' in sowing and reaping, planting and gathering, e.g., corn and potatoes".¹⁰³ Under the *Statute of Frauds*, growing crops of this nature were

⁹⁹"Land" is defined in *The Conveyancing and Law of Property Act*, R.S.O. 1970, c. 85, s. 1(1)(b) as including: "messuages, tenements, hereditaments, whether corporeal or incorporeal, and any undivided share in land". The definition in *The Registry Act*, R.S.O. 1970, c. 409, s. 1(d) reads as follows: "'land' means land, tenements, hereditaments and appurtenances and any estate or interest therein".

¹⁰⁰See, generally, Benjamin, footnote 54 *supra*, paras. 82-92; Fridman, footnote 94 *supra*, pp. 11-12.

¹⁰¹For the post-1893 characterization of the rights of entry, see *Jones & Sons Limited v. Tankerville*, [1909] 2 Ch. 440; and, *Waimiha Sawmilling Co. Ltd. v. Howe*, [1920] 39 N.Z.L.R. 681 (C.A.).

¹⁰²*Lee v. Risdon* (1816), 129 E.R. 76.

¹⁰³*Saunders v. Pilcher*, [1949] 2 All E.R. 1097, 1104, 31 T.C. 314 (C.A.).

treated as chattels and not as part of the land or an interest in land, and an agreement for the sale of such crops, whether mature or immature, and whether the property in them was purportedly transferred before or after severance, was not governed by section 4.

The second, more limited, exception involved *fructus naturales*; that is, the natural growth of the soil, such as grass, timber and fruit on trees. Initially, and before severance, they were regarded as part of the soil, and a contract that purported to convey an immediate interest in them while still in their attached state was held to be a sale of an interest in land and, hence, subject to section 4. However, in *Marshall v. Green*,¹⁰⁴ a unanimous Court of Common Pleas held that a contract for the sale of standing timber to be cut down and removed by the buyer as soon as possible, was a transaction within section 17 dealing with the evidentiary requirements of a sale of goods, and not section 4. The Court reasoned that, since the trees were in a mature state, the soil served as a kind of warehouse and not to provide further nourishment.

Though this rationale could well have been extended to a much broader category of things, the pre-1893 cases showed no disposition to do so. Even before *Marshall v. Green* it had been held that the sale of a fixture, other than the sale by a tenant of a tenant's fixtures, was within the reach of section 4; and in *Lavery v. Pursell*¹⁰⁵ Chitty J., refused to apply the principle in the *Marshall* case to a contract for the sale of a building which was to be demolished by the buyer. *Morgan v. Russell*,¹⁰⁶ although decided after the *Sale of Goods Act, 1893*, indicates that the same opposition would have been shown towards an attempt to extend the doctrine to a contract for the sale of minerals.

The Sale of Goods Act, section 1(1)(g), defines goods to include "emblems, industrial growing crops, and things attached to or forming part of the land that are agreed to be severed before sale or under the contract of sale". It is not clear whether Chalmers intended to reproduce the narrow construction of the effect of *Marshall v. Green* reflected in the above cases, or whether, in contrast to his usual approach, he sought to establish an enlarged meaning of goods, beyond the meaning warranted by the case law. Unfortunately, this part of the statutory definition of goods lends itself to both interpretations and is ambiguous in other respects. All three categories enumerated in section 1(1)(g) raise difficult questions that require brief comment. "Emblems" is a species of *fructus industrielles* and describes the crops, growing at the determination of an estate of uncertain duration, that the tenant is entitled to cut and take away.¹⁰⁷ It is not clear why Parliament thought it needed separate enumeration; it may have been done out of an excess of caution. The learned editors of *Benjamin's Sale of Goods* express the view that "as a subject of sale, the term 'emblems' appears to be intended to mean simply *fructus industrielles*".¹⁰⁸ If this interpretation is correct, it appears

¹⁰⁴(1875), 1 C.P.D. 35.

¹⁰⁵(1888), 39 Ch. D. 508.

¹⁰⁶[1909] 1 K.B. 357.

¹⁰⁷See, *Benjamin's Sale of Goods* (1974), pp. 58-59.

¹⁰⁸*Ibid.*, p. 59.

to make superfluous the specific reference to the second category, "industrial growing crops". Benjamin's explanation of the duplication is that the latter term was added to the definition when the *Sale of Goods Act, 1893*, was extended to Scotland. To add to the confusion, we are told¹⁰⁹ that "industrial growing crops" is not an expression in regular use in the law of Scotland, and that its meaning may be wider than *fructus industriaes*. It is doubtful that other Commonwealth jurisdictions appreciated the subtlety of these distinctions when they adopted the U.K. Act, and the case for resolving the ensuing ambiguities hardly needs labouring.

What then was the meaning intended to be conveyed by the third category, "things attached to or forming part of the land"? The words lend themselves to three possible interpretations. The first reads them literally and therefore leads to the conclusion that the common law definition of goods has been greatly enlarged. As a result, such diverse categories of things attached to land as fixtures, minerals, and structures can now constitute the subject of a present sale. On the whole, however, text-writers¹¹⁰ read the words *ejusdem generis* with emblements and industrial growing crops, and thus restrict their meaning to all or certain types of growing crops. Counsel in *Morgan v. Russell*¹¹¹ adopted this rendering and, at least *sub silentio*, it appears to have won the Court's support. The third reading is a variant of the second and appears to construe "things attached to and forming part of the land" as applying to *fructus naturales*. A substantial number of courts appear to have subscribed to this version. However, almost all the reported cases involve the sale of natural or cultivated products of the soil, and too much should not be read into the judgments. Whichever of these meanings is preferred, all of them raise difficulties. Several of these difficulties, as now discussed, remain to be resolved.

First, must a contract of sale of things attached to or forming part of the land require the things to be severed promptly, where the severance is to be effected by the buyer? The statutory definition does not address itself to this question, and Canadian courts have expressed widely divergent views.¹¹²

Secondly, is it possible for the buyer to obtain title to the goods while they are still attached to the land, given the fact that the goods are not in a deliverable condition within the meaning of the presumptive rules for the passage of title under section 19, Rules 1 to 3, of *The Sale of Goods Act*? The courts in *Morison v. Lockhart*¹¹³ and *Kursell v. Timber*

¹⁰⁹*Ibid.*

¹¹⁰For example, Benjamin, Sutton, Williston.

¹¹¹*Supra*, footnote 106.

¹¹²For example, *Fredkin v. Glines* (1908), 9 W.L.R. 393 (Man. C.A.); *Sharpe v. Dundas* (1911), 18 W.L.R. 86 (Man. C.A.); *Carlson v. Duncan*, [1931] 2 W.W.R. 343 (B.C.C.A.); *McKenzie v. Harvey & Blanchard*, [1930] 1 D.L.R. 547 (N.S.S.C.). For pre-SGA Ontario cases adopting a restrictive view, see, *Summers v. Cook* (1880), 28 Gr. 179; *Handy v. Carruthers* (1894), 25 O.R. 279 (H.C.J.); and, *Ford v. Hodgson* (1901), 3 O.L.R. 526 (Div. Ct.). Compare, *McGregor v. Whalen* (1914), 31 O.L.R. 543 (C.A.).

¹¹³1912 S.C. 1017 (Sc.).

*Operators & Contractors Ltd.*¹¹⁴ appear to have held that the buyer cannot so obtain title, but this view is difficult to reconcile with the wording of the definition of goods and the decision in *Marshall v. Green*.¹¹⁵ A reading of section 19 suggests, however, that the requirement of deliverability only applies where the onus rests on the seller to put the goods into a deliverable condition. If this interpretation is accepted, the difficulty raised by the post-1893 cases disappears.

Thirdly, to what extent is the statutory characterization binding on third parties who claim a real property interest in the subject matter of the sale? In the *Morison* case, the Scottish Court of Sessions held unanimously that the characterization only binds the seller and buyer, and does not affect the rights of third parties. Obviously the conflict is an important one and will have to be resolved if the provisions concerning this class of chattels are to be put on a satisfactory footing in the revised Ontario Act.

It will be convenient to combine further discussion of these difficulties with an examination of the corresponding provisions in Article 2.

(ii) *The Code Provisions*

UCC 2-107 divides things to be severed from realty into two principal categories. The section provides as follows:

- (1) A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this Article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.
- (2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) or of timber to be cut is a contract for the sale of goods within this Article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.
- (3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

Contracts for the sale of minerals "or the like" or a structure or its materials to be removed from the land, fall into the first category.¹¹⁶ These are treated as contracts for the sale of goods, if the things are

¹¹⁴[1927] 1 K.B. 298 (C.A.).

¹¹⁵Supra, footnote 104.

¹¹⁶UCC 2-107(1).

to be severed by the seller. The second category¹¹⁷ comprises growing crops, other things attached to realty and capable of severance without material harm thereto and not falling into the first category, and timber to be cut.¹¹⁸ A contract involving these items is treated as a contract for the sale of goods, whether the subject matter is to be severed by the buyer or the seller, even though it forms part of the land at the time of contracting. It is made explicit that the parties can by identification effect a present sale before severance. However, such contracts are subject to any third party rights provided by the law relating to realty records.¹¹⁹ The buyer can protect his position by recording the contract as a document transferring an interest in land and, if he does so, it will constitute notice to third parties of his rights under the contract.

In the light of the foregoing description it will be seen that the Code's treatment differs substantially from the treatment in *The Sale of Goods Act*. Some of the changes may be welcomed as obvious improvements, but the justification for others is less clear. So far as we have been able to ascertain, there appears to be no practice in Ontario that treats contracts for the sale of minerals, where the buyer is to effect the severance, as contracts other than for the sale of an interest in land;¹²⁰ therefore, this aspect of UCC 2-107(1) can be viewed with equanimity. However, the same cannot be said with respect to the sale of a structure that is to be removed or demolished. In our view, there appears to be no sound reason of policy why such a contract should be treated differently from a contract for the sale of timber.¹²¹

The abolition of the distinction between *fructus naturales* and *fructus industrielles* and the establishment of a single category of "growing crops" in UCC 2-107(2) is a welcome improvement. Also welcome, we think, is the implicit recognition that a sale of fixtures may be treated as a contract for the sale of goods. However, the rationale for the restriction that such things must be capable of severance "without material harm" to the land is less clear. If the seller of the attachments is also the owner of the land he is obviously not prejudiced. He has assumed the risk. If he is not the owner, or if other third parties may be detrimentally affected by the severance, they will have their remedy in damages or otherwise under other branches of law. This is the solution adopted in UCC 9-313 and in the comparable provision in *The Personal Property Security Act*¹²² with respect to the enforcement of a security interest in fixtures. It is difficult

¹¹⁷UCC 2-107(2).

¹¹⁸The pre-1972 Code treated a contract for the sale of timber to be cut as falling within the first category. The change was made in the 1972 Official Text to reflect changes to the 1962 Text adopted by several timber-growing states. Apparently, these jurisdictions found that financing of the transaction is facilitated if the timber is treated as goods instead of real estate: see, *Uniform Commercial Code, 1972 Official Text*, pp. 741-42.

¹¹⁹UCC 2-107(3).

¹²⁰Compare the *Bank Act*, R.S.C. 1970, c. B-1, s. 82(5), which requires the bank to perfect a security interest in hydrocarbons by registering required documents in the appropriate land registry or land titles office.

¹²¹It was treated as a contract for the sale of goods under the *Uniform Sales Act* if the building was to be promptly removed: see, Williston, footnote 42 *supra*, sec. 66 and n. 17.

¹²²See, R.S.O. 1970, c. 344 as am., s. 36(4).

to see how the position of third parties will be improved by treating the transaction as exclusively a contract for the creation of an interest in land.

The requirement that contracts of this hybrid category must be registered in the appropriate land registry office in order to perfect the buyer's interest vis-à-vis realty claimants, is also a welcome clarification. As we construe the Code provisions, registration will not confer on the buyer a better title than his seller had, or had power to confer; and, if the seller was not empowered to authorize severance of the things, the buyer must suffer the consequences. But the converse rule also applies: namely, that registration by the buyer in the appropriate land registry office would confer upon the buyer the protection against realty claimants afforded any purchaser of land. This approach is consistent with one reading of the decision in *Morison v. Lockhart*.¹²³ The adoption of a registration provision in Ontario would bring the law into harmony with similar provisions involving the perfection of security interests in fixtures.¹²⁴ Accordingly, we recommend that a provision similar to UCC 2-107(3) be adopted in the revised Act, and our Draft Bill so provides.¹²⁵

Next, we turn to the Code's treatment of the time of severance. The Code attaches no requirement that the goods must be severed within any particular period. This permissiveness may occasion some surprise, given the fact that it is not unusual to find contracts for the sale of timber that is not to be cut, or that do not require the buyer to effect severance, for several years. However, the difficulty is more apparent than real. So far as the parties themselves are concerned, there is no more reason to restrict their right to determine the duration of the contract than there is in the case of other long term contracts. So far as third parties are concerned, if they claim a realty interest in the goods they will be protected by the registration requirement noted above. If their interest in the goods arises *qua* goods, they will be entitled to the protection afforded by the provisions in Article 2 dealing with the effect of goods left in the seller's possession after identification or sale of goods "entrusted" to a merchant.¹²⁶

There remains for discussion the provisions of the Code relating to the conditions that must be satisfied before the buyer obtains an identifiable interest and/or title in the things attached to the land. As is discussed in chapter 11, the Code's general approach to the transfer of title between seller and buyer, and its significance for the solution of particular problems, is quite different from the rules obtaining under *The Sale of Goods Act*. In the case of a contract for the sale of existing and identified goods, and in the absence of explicit agreement to the contrary, the buyer obtains a special property and an insurable interest in the goods as soon as the contract is made.¹²⁷ If the contract is for the sale of future crops, identification is deemed to occur when the crops are planted or otherwise

¹²³*Supra*, footnote 113.

¹²⁴For example, *The Conditional Sales Act*, R.S.O. 1970, c. 76, s. 10 (now repealed), and its successor, *The Personal Property Security Act*, footnote 122 *supra*, s. 36. For the history of the earlier provisions, see Goode and Ziegel, footnote 35 *supra*, ch. 16, pp. 173-78.

¹²⁵See, Draft Bill, s. 2.5(3) and (4).

¹²⁶See, UCC 2-403(2).

¹²⁷UCC 2-501(1)(a).

become growing crops, provided that the crops are to be harvested within twelve months or the next normal harvesting season after contracting, whichever is longer.¹²⁸ In neither case does Article 2 require the goods to be in a deliverable condition. As has already been noted, UCC 2-107(2) also expressly provides, in the case of a contract for the sale of crops and other things attached to realty, that the parties can by identification "effect a present sale before severance". These provisions therefore dispose of the problem that troubled the courts in *Morison v. Lockhart*¹²⁹ and *Kursell v. Timber Operators & Contractors Ltd.*¹³⁰ Even in the absence of title, a special property is sufficient to give the buyer a right of action against a third party for wrongful dealing with identified goods, other than injury resulting from the destruction or conversion of the goods.¹³¹

The transfer of risk provisions may create some difficulties in their application to things attached to land. UCC 2-509(3) provides that in any case not within the preceding subsections, which do not apply to the contracts under consideration, "the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery". Neither limb of this rule appears particularly apposite in the case of goods that are to be severed by the buyer. Conceivably, the courts may be willing to apply a generous interpretation to the meaning of "receipt" and "tender of delivery", or they may hold, as the section permits them to do, that the parties must have intended a different rule to apply. It is also open for consideration whether the merchant/non-merchant dichotomy is meaningful in a contract of sale where the buyer is responsible for the severance of the things attached to the land. It will be convenient to postpone further discussion of issues of transfer of risk until a later part of this Report.¹³²

(iii) *Conclusions*

It is obvious that the ambiguous definition of goods in *The Sale of Goods Act* needs clarification in its application to things attached to land. The difficulty is to determine where the line should be drawn or what criteria should be adopted. We prefer a twofold test based (a) on current or foreseeable practices, and (b) on the comparative merits of applying real property or personal property rules to determine the parties' rights and obligations under the contract in question. In short, we favour a functional test that is not wedded to traditional property classifications.

Guided by this approach we do not find the provisions of UCC 2-107 entirely satisfactory. The principal difficulties are those caused by the inclusion of "a structure or its materials" in subsection (1) and the requirement in subsection (2) that "other things attached to realty" must be capable of severance without material harm. The balance of the section appears to be satisfactory. To resolve the existing doubts, it should also be made clear that the time of severance is not material so long as sever-

¹²⁸UCC 2-501(1)(c).

¹²⁹Supra, footnote 113.

¹³⁰Supra, footnote 114.

¹³¹UCC 2-722(a).

¹³²Infra, ch. 11.

ance is intended under the terms of the contract. We have therefore revised UCC 2-107 to implement the suggested changes, and have included in our Draft Bill the following provision:¹³³

- (1) A contract of sale of minerals, hydrocarbons or other substances to be extracted from land is a contract of sale of goods if they are to be severed by the seller, but until severance a purported present sale thereof that is not effective as a transfer of an interest in land is effective only as a contract to sell.
 - (2) A contract of sale, apart from the land, of growing crops, timber, fixtures or other things attached to the land that are intended to be severed under the contract of sale is a contract for the sale of goods
 - (a) whether the subject matter is to be severed by the buyer or by the seller; and
 - (b) even though the subject matter forms part of the land at the time of contracting and severance is to be at a later time;
 and the parties can by identification effect a present sale before severance.
 - (3) The rights of a buyer under subsection 2 are subject to the interest of any person, other than the seller, who had a registered interest in the real property at the time of the contract of sale, and are subject to the interest of,
 - (a) a subsequent purchaser or mortgagee for value of an interest in the real property;
 - (b) a creditor with a lien on the real property subsequently obtained as a result of judicial process; or
 - (c) a creditor with a prior encumbrance of record on the real property in respect of subsequent advances,
 if the subsequent purchase or mortgage was made or the lien was obtained or the subsequent advance under the prior encumbrance was made or contracted for, as the case may be, without actual notice of the contract of sale.
 - (4) A notice in the form prescribed by the regulations may be registered in the proper land registry office and thereupon it shall, for the purposes of subsection 3, constitute actual notice of the buyer's rights under the contract of sale.
- (g) RECOMMENDED DEFINITION OF "GOODS"

In light of the preceding discussion, it may be useful to set out our proposed new definition of goods. This definition incorporates the recommendations made above, and provides as follows:¹³⁴

¹³³See, Draft Bill, s. 2.5.

¹³⁴*Ibid.*, s. 1.1(1)16.

'goods' means movable things, and includes the unborn young of animals, growing crops and other things attached to or forming part of land as provided in section 2.5, but does not include the money in which the price is to be paid or things in action.

5. THE PRICE

Section 2 of *The Sale of Goods Act* stipulates that the price must be payable in money. An exchange or barter of goods will not satisfy the statutory test.¹³⁵ This bland statement, however, requires some important qualifications. It is clear, for example, that a price which is to be satisfied by the sale from the buyer to the seller of goods of equivalent or greater value, will meet the prescribed test. It is equally well settled that the price may be paid partly in cash and partly by means of a trade-in or other exchange, at any rate where the value of the trade-in is monetized.¹³⁶ What remains excluded, therefore, is a pure barter agreement that is not tainted by any mention of a monetary figure.

It is difficult to justify the insistence on a monetary consideration. UCC 2-304 does not do so. It provides as follows:

(1) The price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer.

(2) Even though all or part of the price is payable in an interest in realty the transfer of the goods and the seller's obligations with reference to them are subject to this Article, but not the transfer of the interest in realty or the transferor's obligations in connection therewith.

It may be argued that, where a simple exchange or other non-monetary form of consideration is involved, it will be difficult to assess damages if either party breaches his contract. But this will be true however the contract is characterized. The real question, in our opinion, is whether sales rules should be applied by analogy to a contract involving non-monetary consideration, or whether it would be simpler to absorb such transactions into sales law by expanding the definition of price. While acknowledging that the problem is not of the first magnitude, we prefer the latter solution. We therefore recommend the adoption of the Code section, and our Draft Bill contains a provision to this effect.¹³⁷

6. NEAR SALES — INTEGRATION OR ANALOGY?

The function of a legal concept is to identify the common elements in a recurring phenomenon, so that a common set of rules can be applied. The rules themselves will rarely be unique and their rationales may often lend themselves just as readily to a broader range of transactions than

¹³⁵Compare, *Simpson v. Connolly*, [1953] 1 W.L.R. 911 (Q.B.); *Robshaw Bros. Ltd. v. Mayer*, [1957] Ch. 125, [1956] 3 All E.R. 833.

¹³⁶G. J. Dawson (Clapham) Ltd. v. H. & G. Dutfield, [1936] 2 All E.R. 232 (K.B.).

¹³⁷See, Draft Bill, s. 2.6.

those isolated in the defining statute or the judicially contructed categories. Indeed, many of the rules may only be particularized applications of a general principle to a class of transactions. This is particularly true in the sales area.

Of present interest, there are transactions that do not fall within the category of sales, but that, nevertheless, contain some elements that are common to sales. The task of applying, by analogy, sales rules to these closely related transactions in the absence of a statute will devolve upon the courts. Once codification is approached however, or an existing code is being revised, the definitional and analogical problems cannot be ignored. What then is the most desirable approach with respect to the treatment of near-sales in the revised Act? As the preceding pages have tried to indicate, there are many points at which the established contract of sale intersects with such near-sales transactions as contracts for work and materials and contracts for the hire or leasing of chattels. The common issues may touch the consensual elements of the transaction (the formation of the agreement, the parties' obligations and their performance, remedies for breach and so forth), and only be of interest to the parties themselves. In other instances, disparate classifications may affect the rights of third parties such as creditors or persons buying goods from the party in possession.

It would be tempting to ignore the problem and to continue, as before, to leave the task of integration and assimilation to the courts, without any form of guidance. However, this does not appear to be a satisfactory solution. The judicial response to analogical problems has been uncertain. Even at this late stage, for example, it is unsettled to what extent the implied warranties in *The Sale of Goods Act* apply to a leasing contract.¹³⁸ In addition, as Justice Stone lamented in a celebrated article in the Harvard Law Review,¹³⁹ the courts have been particularly reluctant to treat statute law "as both a declaration and a source of law, or as a premise for legal reasoning". Some more specific initiatives would therefore appear to be in order.

In the earlier sections of this chapter attention has been drawn to a number of possible approaches. Some of these have already been adopted, in the Code or elsewhere, while others were put forward by us in the form of recommendations. The following approaches are among the more important:

- (1) To expand the definition of sale in the revised Act so that it will capture transactions that, at present, are outside this definition. As has been noted, the Code has adopted this approach in its definition of "price". However, as a noted American scholar has pointed out,¹⁴⁰ it may be dangerous to assimilate related types of transactions under a common label, because a solution

¹³⁸Infra, ch. 9.

¹³⁹Stone, "The Common Law in the United States" (1936), 50 Harv. L. Rev. 4, 13.

¹⁴⁰Farnsworth, "Implied Warranties of Quality in Non-Sale Cases" (1957), 57 Col. Law Rev. 653.

that may be apt to one type of problem may be inappropriate to another.

- (2) A more selective approach may, therefore, be desirable; for example, by extending particular provisions in the revised Act to specific types of near-sales. This solution has been recommended earlier¹⁴¹ with respect to the applicability of the implied warranties to the material supplied under a contract of work and materials.
- (3) The verbatim application of a sales rule may not always be desirable because of perceived differences between the two types of transaction. For example, it may be felt that a lessor should not be required to warrant his title in a true leasing transaction. In such cases the preferred route may be *to adapt* the sales rules to the near-sale transaction as has been done, in the case of hire-purchase agreements, in the U.K. *Supply of Goods (Implied Terms) Act 1973*.¹⁴²
- (4) Yet another approach, said to have been adopted in the Code,¹⁴³ is to express in open textured language those provisions that are deemed to be capable of wider application to transactions in goods not technically amounting to a contract of sale. It has been suggested that this may be true of some twelve sections of Article 2. There is nothing wrong with this legislative technique, provided that it is systematically applied and provided that the draftsmen's objectives are clear to the average reader. Neither of these tests appears to be satisfied in the case of Article 2, and the Code's approach is not therefore recommended for adoption in Ontario.
- (5) A final possibility is to insert an explicit provision in the revised Act empowering the courts to apply all or any part of the Act to a related type of transaction, where the reason of the sales rule also applies to all or any aspect of the transaction in question. There is no precise exhortation to this effect in Article 2; but there is ample evidence¹⁴⁴ that the Code's sponsors intended the Code to serve as a baseline for further development of commercial law. Moreover, this analogical approach has won warm support among commentators¹⁴⁵ and in the better reasoned decisions.¹⁴⁶

¹⁴¹*Supra*, p. 48.

¹⁴²1973, c. 13 (U.K.), ss. 8-9.

¹⁴³Speidel, Summers & White, *Teaching Materials on Commercial Transactions* (1969 ed.), pp. 457-58.

¹⁴⁴See, for example, UCC 1-102(1), and especially Comment 1.

¹⁴⁵For example, Farnsworth, footnote 140 *supra*; Murray, "Under the Spreading Analogy of Article 2 of the Uniform Commercial Code" (1971), 39 Fordham L. Rev. 447.

¹⁴⁶For example, *Newmark v. Gimbel's Inc.* (1969), 258 A. 2d 697 (N.J.); *Worrell v. Barnes* (1971), 484 P. 2d 573 (Nev.); *Colt v. Fradkin* (1972), 281 N.E. 2d 213 (Mass.); and compare, *Rose Acre Farms Inc. v. L. P. Cavett Co. of Ind.* (1972), 279 N.E. 2d 280 (Ind.); *Garfield v. Furniture Fair-Hanover* (1971), 274 A. 2d 325 (N.J.).

Although we are not unanimous in our conclusion,¹⁴⁷ we are of the opinion that a general analogical provision would serve a number of useful purposes. In the first place, it will encourage the courts to consider the analogical issue, to examine the rationale of the sales rule, and to give considered reasons why the sales rule should or should not be followed, depending on the court's conclusion. Secondly, the analogical technique affords maximum flexibility and therefore avoids the pitfalls of total assimilation or integration. Finally, it provides a bridge between a separate statutory regime for near-sale transactions, which is not likely to emerge in the foreseeable future, and no guidance at all. A majority of the Commission therefore recommends that the revised Act should contain a provision empowering the court to apply any provision of the Act by way of analogy to transactions other than sales transactions. Accordingly, there should be included in the revised Act a provision to the effect that any of the provisions of the Act "... if relevant in principle and appropriate in the circumstances, may be applied by analogy to a transaction respecting goods other than a contract of sale such as a lease of goods or a contract for the supply of labour and materials".¹⁴⁸ We appreciate that our recommendation amounts to little more than a legislative endorsement of an accepted practice. The provision will not alter radically the law of near-sales; nor is this our intention. It is to be hoped, however, that our recommendation will encourage the law of sales and near-sales to develop in greater harmony with each other.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The distinction between a merchant and non-merchant buyer or seller, contained in Article 2, should be applied in the revised Act in a limited range of circumstances turning on functional considerations.
2. The nature of the interest of a conditional buyer should be clarified. The revised Act should make it clear that the seller's retention of title in the case of a conditional sale agreement is limited to the retention of a security interest.
3. The revised Act should make it clear that its provisions apply to the sales incidents in a conditional sale agreement. The revised Act should not apply to a transaction that is intended to operate *only* as a secured transaction.
4. The definition of contract of sale in the revised Act should make it clear that the Act applies to a case where the seller does not

¹⁴⁷One of the Commissioners, the Honourable J. C. McRuer, wishes to dissent from this recommendation. In Mr. McRuer's view, section 2.2(4) as drafted, if enacted, would be an evasion of the responsibility of the Legislature to declare what the law is, and leaves it to the judges to make the law as the cases arise. This is not helpful to those engaged in business or to their advisers. The matter should be further considered by the Commission, and recommendations made for appropriate legislation.

¹⁴⁸See, Draft Bill, s.2.2(4).

warrant his title, or has otherwise excluded or restricted the implied warranty of title under the Act.

5. The revised Act, following UCC 2-105, should apply to the sale of a part interest in existing identified goods, whether or not the sale is a sale between co-owners. The revised Act should also apply to the sale of an undivided share in an identified bulk of fungible goods, even though the quantity of the bulk is not determined.
6. The definition of contract of sale should include a contract for the supply of goods to be manufactured or produced by the seller, whether or not the goods are made specially to the buyer's order, and without regard to the relative value of the labour or materials involved in the production or manufacture of the goods.
7. The implied warranties in the revised Act should apply to the materials supplied under a contract of work and materials, other than a contract falling within recommendation No. 6 *supra*, where the work or services are supplied *in addition* to the materials but as part of the same contract.
8. With respect to contracts of bailment, equipment leases, and hire-purchase agreements:
 - (a) The revised Act should provide that, whether or not a contract in the form of a lease of goods, bailment, hire-purchase, consignment or otherwise is a contract of sale, depends upon the intention of the parties, the substantial effect of the contract, and all the other surrounding circumstances.
 - (b) The implied warranties in the revised Act should apply, with modifications, to true chattel leases, as more particularly set forth in chapter 9, *infra*.
 - (c) The question of what, if any, statutory provisions are desirable to clarify the quantum of damages recoverable by a lessor in a true chattel lease for breach of the agreement by the lessee, should be referred for study to the Advisory Committee on The Personal Property Security Act.
9. The revised Act should contain a new definition of "goods". The new definition should incorporate the concept of "movable things", should clarify the position of "money" by excluding only "the money in which the price is to be paid", and should recognize the "unborn young of animals" as a separate category of goods. The new definition should read as follows:

'goods' means movable things, and includes the unborn young of animals, growing crops and other things attached to or forming part of land as provided in section 2.5, but does not include the money in which the price is to be paid or things in action.
10. The definition of "goods" in *The Personal Property Security Act*

should be amended to harmonize with the definition of "goods" in the revised Sale of Goods Act.

11. The present ambiguous definition of goods should be clarified in its application to things attached to or forming part of land. The following functional test, not wedded to traditional property classifications and modelled, in part, on UCC 2-107, should be adopted in the revised Act:

(1) A contract of sale of minerals, hydrocarbons or other substances to be extracted from land is a contract of sale of goods if they are to be severed by the seller, but until severance a purported present sale thereof that is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract of sale, apart from the land, of growing crops, timber, fixtures or other things attached to the land that are intended to be severed under the contract of sale is a contract for the sale of goods

(a) whether the subject matter is to be severed by the buyer or by the seller; and

(b) even though the subject matter forms part of the land at the time of contracting and severance is to be at a later time;

and the parties can by identification effect a present sale before severance.

(3) The rights of a buyer under subsection 2 are subject to the interest of any person, other than the seller, who had a registered interest in the real property at the time of the contract of sale, and are subject to the interest of,

(a) a subsequent purchaser or mortgagee for value of an interest in the real property;

(b) a creditor with a lien on the real property subsequently obtained as a result of judicial process; or

(c) a creditor with a prior encumbrance of record on the real property in respect of subsequent advances,

if the subsequent purchase or mortgage was made or the lien was obtained or the subsequent advance under the prior encumbrance was made or contracted for, as the case may be, without actual notice of the contract of sale.

(4) A notice in the form prescribed by the regulations may be registered in the proper land registry office and thereupon it shall, for the purposes of subsection 3, constitute actual notice of the buyer's rights under the contract of sale.

12. The revised Act should contain a provision comparable to UCC

2-304 permitting the price to be payable in money "or otherwise".

- *13. The revised Sale of Goods Act should contain a general provision empowering the court to apply any provisions of the Act by way of analogy to transactions other than sales transactions. Accordingly, there should be included in the revised Act a provision to the effect that any of the provisions of the Act ". . . if relevant in principle and appropriate in the circumstances, may be applied by analogy to a transaction respecting goods other than a contract of sale such as a lease of goods or a contract for the supply of labour and materials".
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The Commissions offers no recommendation with respect to the desirability or need for a separate Consumer Sales Act.

* The Honourable J. C. McRuer dissents from this recommendation. See, foot-note 147, *supra*.

PART III

1. INTRODUCTION

The Sale of Goods Act does not deal generally with the rules governing the formation of the contract of sale, the basic policy of the Act being that unless otherwise provided the normal rules of contract shall apply.¹ There are, however, exceptions to this basic policy. The Act contains provisions governing the following matters: namely, capacity to contract by minors and other persons under a disability;² Statute of Frauds writing requirements;³ the effect of mistaken assumptions with respect to the existence of the goods;⁴ the determination of the price where none has been fixed by the agreement;⁵ sales on approval;⁶ and, sales by auction.⁷

It will be convenient to postpone discussion of the questions of price and sales on approval to later chapters. The other provisions are examined here in the light of changes that have occurred since their original adoption, and they are compared with their Code counterparts. The opportunity is taken, at the same time, to review some basic contract doctrines that have an important impact on the formational aspects of the contract of sale and that would appear to be in need of clarification and modernization. The topics so reviewed are the following: namely, some aspects of the law of offer and acceptance, in addition to the rules on sale by auction; the doctrine of consideration; the law of mistake; the parol evidence rule; and, assignment of contractual rights and delegation of performance.

As has been noted in chapter 2, Article 2 of the *Uniform Commercial Code* contains many more provisions on the formational and constructional phases of the contract of sale than does the Ontario Sale of Goods Act. We have studied these provisions of Article 2 carefully, with a view to determining their suitability for inclusion in the revised Ontario Act. Predictably, we concluded that not all the problems that arise in connection with the formation and construction of contracts are susceptible of an easy solution. Several will require further study. In a number of other instances (notably those affecting the doctrine of consideration, contracts for the benefit of third parties, and the law of mistake) we recommend either that changes in the revised Act should, where appropriate, be paralleled by a similar or even broader group of provisions in the proposed Law of Contract Amendment Act, or that the subject at large belongs more appropriately to an Act of the latter type.

¹See, R.S.O. 1970, c. 421, s. 57(1).

²*Ibid.*, s. 3.

³*Ibid.*, s. 5.

⁴*Ibid.*, s. 7.

⁵*Ibid.*, ss. 9-10.

⁶*Ibid.*, s. 19, R. 4.

⁷*Ibid.*, s. 56.

2. CAPACITY TO CONTRACT AND CONTRACTS FOR NECESSARIES

Section 3 of *The Sale of Goods Act* provides as follows:

(1) Capacity to buy and sell is regulated by the general law concerning capacity to contract and to transfer and acquire property, but where necessaries are sold and delivered to a minor or to a person who by reason of mental incapacity or drunkenness is incompetent to contract, he shall pay a reasonable price therefor.

(2) Necessaries in this section mean goods suitable to the conditions in life of the minor or other person and to his actual requirements at the time of the sale and delivery.

This section is not reproduced in Article 2, and it might be thought that a general provision, similar to section 57(1) of the present Act preserving the rules of the common law and equity and suitably expanded to cover contractual capacity, would be adequate. Disputes involving sale contracts with minors appear to be rare and, if the reports are any guide, have disappeared almost completely since the reduction of the age of majority in all provinces from 21 to 18 or 19.⁸

Notwithstanding these arguments, we recommend retention of section 3. Even if its practical importance has greatly diminished, the section does no harm and, until such time as Ontario adopts a comprehensive law dealing with minors' contracts⁹ and contracts with other persons suffering from a disability, it seems to us that some provision, however modest, is better than none at all.

3. OFFER AND ACCEPTANCE

Three sections of the Code will be discussed under this heading. The first two, sections 2-206 and 2-207, have no counterparts in *The Sale of Goods Act*, but raise significant questions of principle that are of everyday importance in the law of sales. The third section, section 2-328, does have a close parallel in section 56 of the Ontario Act, but differs from it in a number of material respects.

(a) UCC 2-206: ACCEPTANCE BY PERFORMANCE¹⁰

Section 2-206 of the *Uniform Commercial Code* provides as follows:

(1) Unless otherwise unambiguously indicated by the language or circumstances

(a) an offer to make a contract shall be construed as inviting

⁸See, for example, *The Age of Majority and Accountability Act*, S.O. 1971, c. 97.

⁹*The Family Law Reform Act*, 1978, c. 2, s. 33, deals with one aspect of minors' contracts for necessities.

¹⁰Compare, Murray, "Contracts: A New Design for the Agreement Process" (1968), 53 Corn. L. Rev. 785, 792-800, and Note, "The Uniform Commercial Code and Contract Law: Some Selected Problems. Part 1. Formation of a Contract-Acceptance" (1957), 105 U. Pa. L. Rev. 839. See, also, Holmes, "The Agreement Process: A Reconciliation of the Required Notice of Performance in UCC 2-206(2)" (1972), 77 Com. L.J. 241.

acceptance in any manner and by any medium reasonable in the circumstances;

- (b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods, but such a shipment of non-conforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

On a first reading, subsection (1)(a) merely appears, with one possible exception, to codify existing Anglo-Canadian jurisprudence with respect to the manner of acceptance of an offer where no particular manner is specified by the offeror. This possible exception is provided by the opening words of the subsection ("unless otherwise unambiguously indicated") which, arguably, tilt the balance more favourably towards the offeree than does the existing law. There is both internal and external evidence, however, that clause (a) was intended to accomplish a more basic change in the law of offer and acceptance, and that it was meant¹¹ to reverse the presumption under earlier American law that an offer normally requires either a promissory acceptance *or* acceptance by performance and that, in case of doubt, the offer should be construed as inviting a promissory acceptance. In other words, "manner of acceptance" in UCC 2-206(1)(a) refers to acceptance by the offeree, either by promising to perform what the offer requests or by rendering the requested performance. Though this intention may be clear to an American lawyer, it would not be obvious to an Ontario reader. We have therefore concluded that any incorporation of section 2-206(1)(a) in the revised Ontario Act should be accompanied by language that makes it clear that acceptance may include performance of the requested Act.

Subsection (1)(b) illustrates the type of offer envisaged in subsection (1)(a). Consider the following example: A forwards an order for goods to B and adds, "please ship as soon as possible". Is shipment of the goods an effective acceptance or does the offer require acceptance by communi-

¹¹Murray, footnote 10 *supra*, at p. 793; and compare, *Restatement of the Law, Contracts 2d, Tent. Draft Nos. 1-7* (Rev. & edited, 1973), ss. 29(2) and 31. Section 29(2), in language almost identical with UCC 2-206(1)(a), reads:

Unless otherwise indicated by the language or the circumstances, an offer invites acceptance in any manner and by any medium reasonable in the circumstances.

Section 31 reads:

In case of doubt an offer is interpreted as inviting the offeree to accept either by promising to perform what the offer requests or by rendering the performance, as the offeree chooses.

The Comment to s. 31 explains in part that "The rule of this Section is a particular application of the rule stated in s. 29(2)."

cation? The effect of the Code rule is to permit either form of acceptance unless the offeror has evinced a contrary intention. It should be emphasized that these provisions are not intended to weaken the rule that the offeror is master of his offer; rather, the theory of subsections (1)(a) and (b) is that the offeror is often indifferent as to whether acceptance takes the form of words of promise or acts of performance, "and his words literally referring to one are often intended and understood to refer to either".¹² Anglo-Canadian law provides no clear guidance with respect to this type of offer,¹³ and we support the inclusion in the revised Act of provisions similar to UCC 2-206(1)(a) and (b), but subject to the clarification mentioned earlier with respect to clause (a).¹⁴

Although performance may be an approved mode of acceptance, it does not dispose of the question whether *notification* of acceptance by the offeree is a prerequisite to the "perfection" of his acceptance.¹⁵ Obviously, the offeror is entitled to know where he stands, unless he has dispensed with notification or is likely to learn promptly by other means of the offeree's acceptance by performance. To illustrate: if the offeror and offeree are in the same city and the offeror places an order for goods for prompt delivery, separate notification of acceptance may reasonably be assumed to be waived. If, however, the offeror lives a considerable distance from the seller's place of business, notification would seem to be a proper requirement. Section 56(2) of the Tentative Draft of the *Second Restatement on Contracts* appears to us to strike the right balance. It provides as follows:

- (2) If an offeree who accepts by rendering a performance has reason to know that the offeror has no adequate means of learning of the performance with reasonable promptness and certainty, the contractual duty of the offeror is discharged unless
 - (a) the offeree exercises reasonable diligence to notify the offeror of acceptance, or
 - (b) the offeror learns of the performance within a reasonable time, or
 - (c) the offer indicates that notification of acceptance is not required.

It appears from section 63 of the *Restatement*, which we discuss

¹²*Restatement of the Law, Contracts 2d, Tent. Drafts Nos. 1-7*, (Rev. & edited, 1973), Comment to section 31.

¹³Compare, Treitel, *The Law of Contract* (3rd ed., 1970), p. 21, and *ibid.* (4th ed., 1975), p. 16. The Research Team's analysis of contractual forms used by CMA respondents shows that occasionally a purchase order will expressly authorize acceptance by shipment.

¹⁴See, Draft Bill, s. 4.4(1)(a) and (b).

¹⁵The term "perfection" is used in deference to the criticism by Professor Murray, footnote 10 *supra*, of the Code's suggestion that there is no acceptance until notification. He prefers the language in *Restatement of the Law, Contracts 2d*, ss. 56 and 63, which indicates that there is acceptance by performance, but that the offeror's contractual duty is "discharged" unless notification is given in the required circumstances. See, also, Holmes, footnote 10 *supra*, at pp. 244-45.

below, that the tender or beginning of an invited performance is treated as an acceptance by performance, so that the notice requirement under section 56(2) applies to both partial and completed acts of performance. The formulation in section 56(2) is, in our view, much more felicitous than the ambiguous language of section 2-206(2), and we recommend its adoption in the revised Act. The Code provision suggests that notification is ordinarily only required where the offeree is relying on the beginning of a requested performance to demonstrate acceptance. This inference was probably not intended, given the duty of notification imposed upon a shipping seller under UCC 2-504(c),¹⁶ but again this would not be evident to the average reader.

Section 2-206(2) of the Code also raises a problem that has been much discussed in Anglo-American legal literature in the context of unilateral contracts:¹⁷ namely, can the offeror revoke his offer before the offeree has completed the act of performance which, under the terms of the offer, entitles him to claim the promised consideration? The better view is that he cannot;¹⁸ at any rate, not where an injustice would otherwise be done to the offeree. Section 45 of the *First Restatement* adopted such a rule in the case of unilateral contracts,¹⁹ and section 63 of the Tentative Draft of the *Second Restatement* has now extended the rule to all cases where the offer invites acceptance by promise or performance. Section 63 provides as follows:

(1) Where an offer invites an offeree to choose between acceptance by promise and acceptance by performance, the tender or beginning of the invited performance or a tender of a beginning of it is an acceptance by performance.

(2) Such an acceptance operates as a promise to render complete performance.

The opening part of UCC 2-206(2) ("Where the beginning of a requested performance is a reasonable mode of acceptance") implies the same rule. In our view, however, section 63(1) states the position more clearly, and we recommend the adoption of its language in the revised Act in preference to the formulation in UCC 2-206(2).²⁰

There is another reason for our preference. UCC 2-206(2) provides no guidance as to the circumstances in which the beginning of a requested

¹⁶See, UCC 2-206, Comment 2; and compare, Murray, footnote 10 *supra*, at p. 799. Note, however, that failure to notify under UCC 2-504(c) does not nullify the acceptance; it merely amounts to breach of the seller's contractual obligations.

¹⁷See, for example, H. W. Ballantine, "Acceptance of Offers for Unilateral Contract by Partial Performance of Service Requested" (1921), 5 Minn. L. Rev. 94; Llewellyn, "Our Case Law of Contract: Offer and Acceptance, II" (1939), 48 Yale L.J. 779, 802-18; Treitel, *The Law of Contract* (4th ed., 1975), pp. 35-40; White & Summers, *Handbook of Law Under The Uniform Commercial Code* (1972), pp. 34-36.

¹⁸See, *Errington v. Errington*, [1952] 1 All E.R. 149 (C.A.), at p. 153 (*per Lord Denning*).

¹⁹The rule appears in section 45 of the *Second Restatement*, footnote 12 *supra*.

²⁰See, Draft Bill, s. 4.4(2)(a).

performance is a reasonable mode of acceptance. On the face of it, it seems a paradoxical requirement, for it is difficult to conceive of the beginning of a *requested* performance that is not a reasonable mode of acceptance, and no such qualification appears in section 63(1) of the *Second Restatement*. Conceivably, what the Code draftsmen had in mind was that, to constitute acceptance, the beginning of the requested performance "must unambiguously express the offeree's intention to bind himself". This is the language used in Comment 3 to section 2-206; but it does not amount to the same thing as the requirement that there must be a reasonable mode of acceptance. To illustrate: A forwards an order to B for 1,000 suits to be manufactured and delivered over the next three months, and adds "please start work at once". B had previously altered his production schedule in anticipation of this type of order and therefore does not need to give new instructions to his floor staff. B's proceeding to manufacture the requested suits would be a reasonable mode of acceptance, assuming it is followed by reasonable notification to the offeror, but it would be difficult to argue that B's merely telling his staff about A's order amounts to an unambiguous act of acceptance. The need for an unequivocal act is implicit in the concept of part performance and would, we believe, in this context readily be appreciated by the courts. Moreover, the additional requirement of notice to the offeror provides the necessary safeguard that the offeree will not be able to play fast and loose with his order, and will usually resolve any lingering doubts that may remain with respect to the offeree's intentions.

Finally, it should be noted that, pursuant to section 63(2), the acceptance constituted by part performance is a promissory acceptance and, unlike a unilateral contract, binds the offeree to render complete performance. This conclusion follows from the character of the offer and ensures reciprocity between the parties: the offeror cannot withdraw his offer once the requested performance has been begun; nor can the offeree refuse to complete performance because it no longer suits his purpose to do so.²¹ The same rule as in section 63(2) is implicit in UCC 2-206(2), since the subsection speaks of the beginning of the requested performance constituting a reasonable mode of "acceptance"; once again, however, we prefer the clearer language of the *Restatement*, and recommend its adoption in preference to the language in UCC 2-206(2).

To sum up, section 2-206 introduces several important concepts that are partly new to Canadian contract law or not adequately covered by authority. In our view, they are worthy of adoption in the revised Ontario Act. However, we favour a synthesized version of UCC 2-206 and sections 56(2) and 63 of the *Second Restatement on Contracts*, so that the meaning of the new provisions will be clear to the Ontario practitioner without the need for extended research into their American origins and judicial interpretation. We have attempted to achieve this objective in our Draft Bill.²²

²¹See, Hawkland, *A Transactional Guide to the Uniform Commercial Code* (1964), Vol. 1, sec. 1.1303, p. 34.

²²See, Draft Bill, s. 4.4.

(b) THE BATTLE OF THE FORMS²³

Few formational problems are more difficult to resolve than the conflict that arises when a buyer and seller use different forms to record the terms upon which they are willing to enter into a bargain. That the use of conflicting purchase order and acknowledgment forms is as common in Ontario as it is in the U.S., emerges clearly from the Research Team's analysis of contractual forms and the replies to the C.M.A. Questionnaire.²⁴ In a typical case the buyer forwards his printed purchase order form, which is made "subject" to the terms and conditions appearing in the same document. The seller responds by sending his acknowledgment or confirmation form, which also contains its own terms and conditions; however, these often differ in material respects from those in the buyer's form.²⁵ Into this basic scenario many variants may be injected. A few examples will suffice: the exchange of forms may have been preceded, or be accompanied, by oral communications; one or other form may reject in advance any modifications to the terms in the form not expressly assented to in writing; or, one form may state a term that is not reproduced in the document of the other party. Most importantly, the parties may proceed with performance on the assumption that a binding agreement has

²³See, also, Research Paper No. II.1 on this topic by Professor Stephen M. Waddams. The American literature is voluminous. See the bibliography in Uniform Laws Annotated, *Uniform Commercial Code*, Vol. 1, pp. 217-19 and Cum. Ann. Pocket Part, and in Barron and Dunfee, "Two Decades of 2-207: Review, Reflection and Revision" (1975), 24 Cleveland S. Law Rev. 171, especially nn. 3-7. A particularly good discussion appears in Duesenberg and King, *Sales and Bulk Transfers Under the Uniform Commercial Code*, Bender's Uniform Commercial Code Service, Vol. 3, ch. 3. For a discussion of some of the problems from an English point of view, see Hodgett, "Changing a Bargain by Confirming It" (1970), 33 Mod. L. Rev. 518.

²⁴See Waddams, Research Paper No. II.1, p. 29. Professor Waddams estimates that as many as 60% of the CMA respondents have had some kind of exposure to potential battle of form conflicts.

²⁵Two contrasting businessmen's views about the value of such forms are worth citing. The first was expressed by a CMA respondent in the following language:

It has been my experience that the mechanics of buying and selling in the private sector in inter-company commerce are much the same the country over. The basis of the system is the exchange of printed Purchase Order Forms and Sales Order Forms. The creation of both forms follows a predictable pattern.

The buyer's system engineer designs the front of the P.O. form such that all information required to communicate his needs are stated. His lawyer then fills up the back of the form.

The seller's systems engineer designs the front of the S.O. form such that effect may be given the buyer's wishes. His lawyer also fills up the back of his form.

The front of the forms is a manifestation of good communications; the back of the forms is a manifestation of what your profession calls the adversary system, I believe.

Fortunately, a conspiracy developed many years ago between Purchasing Agents and Sales Managers under which both agreed not to read the backsides of the other's form. Were it not for this layman's conspiracy, the economy of Ontario would doubtless be destroyed.

A second, and less sceptical, view appears in a manual prepared by another respondent for the guidance of its staff. This describes the use of standard forms as "a practical way of handling thousands of orders per month for standard commercial items not involving systems or other special applications".

been concluded and only "discover" the disparity in the documentary exchanges when the parties are locked in conflict. How should the law resolve this apparent impasse?

Anglo-Canadian contract law has traditionally approached the problem by holding that, to constitute a completed contract, the forms exchanged must contain no variant terms. When this condition is not satisfied, the document later in time, which could be the seller's confirmation or the buyer's purchase order, is not a true acceptance but constitutes a counter-offer; that is, unless the additional terms can be treated as proposals that were not intended to be mandatory in nature.²⁶ There is, therefore, no binding contract and either party may refuse to continue with performance. But if performance has been tendered to and accepted by the buyer after the buyer has received the seller's confirmation, the buyer is deemed to have accepted the seller's counter-offer, at any rate where the seller's confirmation followed receipt of the buyer's order.²⁷ This proposition is sometimes referred to as "the performance rule".

The draftsmen of Article 2 did not feel that the "mirror image"²⁸ and "last shot"²⁹ rules of acceptance prescribed by the common law corresponded with commercial realities. Accordingly, they set out consciously to change the common law position, albeit with much agonizing over the form of the desirable changes and the language in which they should be expressed. The current version of section 2-207 reads as follows:

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

- (a) the offer expressly limits acceptance to the terms of the offer;
- (b) they materially alter it; or
- (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

²⁶*Hyde v. Wrench* (1840), 3 Beav. 334; 49 E.R. 132 (Ch.); *Harvey v. Perry*, [1953] 1 S.C.R. 233, especially at 237; and see, further, Fridman, *The Law of Contract in Canada* (1976), pp. 70-71.

²⁷Compare, *Corbin on Contracts*, Vol. 1, p. 319, and *Roto-Lith Ltd. v. Bartlett & Co. Inc.* (1962), 297 F. 2d 497. For a striking example, in a bailment context, of the gamesmanship to which the rule can lead see, *British Road Services, Ltd. v. Arthur V. Crutchley & Co. Ltd.*, [1968] 1 All E.R. 811, Waddams, Research Paper No. II.1, pp. 19-22.

²⁸That is, the rule that an acceptance must be unqualified and may not deviate in any respect from the terms in the offer.

²⁹That is, the rule that a counter-offer will be deemed to be accepted if the other party acts upon it as, for example, by receiving the goods without objection.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

The objectives sought to be attained by these provisions are fairly readily discernible. Subsection (1) abolishes the mirror image rule and treats a confirmation as an acceptance, even though it stipulates additional or different terms. By virtue of subsection (2) the additional, but not different, terms are to be construed as proposals for additions to the contract. Subsection (2) also states the circumstances in which the additional terms are deemed to have been accepted by the other party. Subsection (3) addresses itself to the legal position where the offeree's communication cannot be treated as an acceptance, but the parties have proceeded on the assumption that a binding contract exists. In such a case, the conflicting terms are to be disregarded, and the contents of the contract are to be found in those terms with respect to which the parties are in agreement, combined with any supplemental provisions added by the Code. It seems clear that the draftsmen rejected the performance rule and wanted to deprive the seller of any advantage that might have been conferred on him under prior case law because of the fortuitous circumstance that his confirmation was later in time than the buyer's purchase order.

However meritorious the draftsmen's overall objectives may have been (and this too is a matter for serious debate), there is general agreement that section 2-207 is not well drafted and that it raises as many issues as it solves.³⁰ In the colourful language of White and Summers,³¹ the section is in one respect "like the amphibious tank that was originally designed to fight in the swamps, but was ultimately sent to fight in the desert". Two other learned authors³² have objected strenuously that "the section was apparently drafted without assessing costs and without balancing against them the advantages the section might afford". Even its friendlier critics admit that the section is "one of the most important, subtle, and difficult in the entire Code".³³

The following are some of the many constructional and conceptual problems said to be raised by the section:

- (1) the use of conventional terms to express unconventional ideas; in particular, the notion that there can be an acceptance of an offer or confirmation of a verbal agreement even though the "acceptance" or "confirmation" contains different or additional terms from those found in the offer or verbal agreement;

³⁰Professor Shanker disagrees with the critics. In his view, section 2-207 is a "fairly simple, straight-forward, and extraordinarily progressive section": Shanker, "Contract by Disagreement!? (Reflections on UCC 2-207)" (1976), 81 Com. L.J. 453.

³¹*Supra*, footnote 17, p. 24.

³²Friedman & Macaulay, "Contract Law and Contract Teaching: Past, Present, and Future", [1967] Wis. L. Rev. 803, 818, cited in Waddams, Research Paper No. II.1, p. 72.

³³Duesenberg and King, footnote 23 *supra*, p. 3-12.

- (2) the meaning of the words "definite and seasonable expression of acceptance" in subsection (1);
- (3) the difficulty of distinguishing between "additional" and "different" terms for the purpose of applying subsections (1) and (2);
- (4) the need for an offeree to condition his acceptance upon express assent to different or additional terms contained in his response, when no requirement is imposed on the offeror to indicate his objections to such variant terms, except in the case of non-material additions; and,
- (5) the hardship imposed by subsection (3) in depriving sellers of the protection of disclaimer clauses in their forms because of the existence of conflicting writings, especially in cases where the goods have been shipped to and accepted by the buyer.

During the course of this Project, a research paper was prepared that subjected the provisions of section 2-207 to a searching examination.³⁴ The research paper reached the conclusion that many of the criticisms were valid.³⁵

The Commission agrees with the Research Team that section 2-207 is not satisfactory in its existing form, and that more than cosmetic changes are necessary in order to find acceptable solutions to the great variety of problems endemic in the "battle of the forms" phenomenon. With one exception, therefore, we do not recommend adoption of the section, although this recommendation is not intended to preclude further study of the whole problem by the Law of Contract Amendment Project. The exception involves subsection (3), which we would incorporate in the revised Act.³⁶

Our reasons are as follows. So long as the "agreement" is still executory and the parties have not proceeded beyond the exchange of forms, there is no undue hardship in applying existing rules of offer and acceptance and finding that there is no concluded agreement between the parties. The "mirror image" rule of acceptance may enable one or the other party to escape from a bargain that he no longer finds to his liking, but such cases do not appear to arise often in practice. In any event, it is always open to a court to find that the offeree did not intend to reject the offer, and that the variant terms in the response, if minor in character, were only in the nature of suggestions.

It is different once the parties have proceeded to act as if there were

³⁴Waddams, "The Effect of Unsigned Writings in the Formation of Sales Contracts: 'The Battle of Forms' and Related Questions", Research Paper No. II.1.

³⁵To some extent Professor Waddams goes further, since he finds the changes from existing Anglo-Canadian concepts of offer and acceptance so radical as to be totally unacceptable. He therefore opposes the adoption of the section, both in form and in substance, in a revision of the Ontario Act. He appears to feel that the courts are capable of resolving problems that arise from the use of conflicting forms and of avoiding hardship to the buyer through the use of constructional techniques and evolving doctrines of unconscionability.

³⁶See, Draft Bill, Section 4.2(3).

a binding contract. Unless one were to argue that the transaction was a nullity, or at least voidable, on the grounds of mutual mistake (a proposition that few have entertained seriously), the court must construct the terms of the bargain on some realistic basis. This is what UCC 2-207(3) attempts to do. It is not realistic to say that, because the last document in the exchange of writings contained the seller's disclaimer clause, or other variant terms, the buyer must therefore be deemed to have assented to them when he accepted the goods.³⁷ The assumption would be clearly fictitious if the buyer's order form had rejected in advance any deviations not approved by him in writing. Should it make a difference that he did not exercise this measure of foresight? Suppose the sequence of events were altered so that the buyer's purchase form, containing a stipulation for an express warranty or other variant term, was received by the seller before he shipped the goods, but after he had dispatched his original offer containing the disclaimer clause. Would the seller still willingly subscribe to the performance rule? As American authors have noted,³⁸ faced with intractable patterns of business behaviour the best solution is for the law to adopt an attitude of evenhandedness, as the Code does. If sellers and buyers do not like the results, they can avoid them by insisting on explicit acceptance of their terms.

In rejecting the performance rule, we do not wish to leave the impression that the court should ignore the parties' conduct after, or before, the exchange of their inconclusive writings. We only argue that any conclusion should be based on persuasive evidence and not fictitious assumptions. The difference between these approaches can be illustrated with the aid of two American decisions, both decided under the Code.

In the first, *Roto-Lith Ltd. v. Bartlett & Co.*,³⁹ the buyer sent the seller a written order for a drum of emulsion to be used by the buyer in its manufacture of cellophane bags for the packaging of vegetables. The order stated: "End use: wet pack spinach bags". The seller's acknowledgment form, which it was assumed reached the buyer before the emulsion, contained a disclaimer of all express and implied warranties. The emulsion turned out to be defective and the buyer sued the seller for breach of warranty. The First Circuit Court of Appeals, in a much criticized decision, applied pre-Code reasoning and held that, since the buyer accepted the goods with presumptive knowledge of the conditions in the seller's acknowledgment, it was bound by the disclaimer provisions.

In the second case, *Construction Aggregates Corp. v. Hewitt-Robins*

³⁷See, Shanker, footnote 30 *supra*, at p. 454, n. 13:

. . . there is a vast distinction (which the common law courts seemed to have overlooked) between one who receives goods from an original offer as opposed to one who receives goods under a counter offer. Most important, the recipient who receives goods under a counter offer simply has not received them in silence. Quite to the contrary, he originally was an offeror himself. And, in that original and prior offer, he loudly and clearly manifested the contractual terms which he expected and would agree to. Thus, to place this recipient in the same legal posture as the recipient who never had said anything during the transaction just plain ignores the actual facts.

³⁸White & Summers, footnote 17 *supra*, p. 25.

³⁹(1962), 297 F. 2d 497.

Inc.,⁴⁰ the buyer again forwarded a purchase order to the seller. The seller signed and returned the order, together with a covering letter stating that acceptance was expressly conditioned upon assent to the modified warranty provision set out in the letter and certain changes in the payment terms. Following receipt of the letter, the buyer's corporate treasurer telephoned the seller objecting to the payment terms in the covering letter but saying nothing about the variations in the warranty provisions. The Court held that the buyer's objection to the payment terms could reasonably be construed as acquiescence in the remaining terms of the counter-offer. While this decision has also been criticized, it can, in our view, be justified. The difference between the two cases is that, while in the *Rotolith* case there was no evidence of acceptance of the seller's variant terms, beyond the fact of the buyer's receipt of the goods, there was at least some independent evidence of acceptance in the *Construction Aggregates* case.

We appreciate that the dividing line may be thought to be a fine one; nevertheless, we believe it to be real. We therefore recommend a solution based upon persuasive evidence as evinced by the conduct of the parties. Accordingly, we have included in the Draft Bill an almost verbatim version of UCC 2-207(3).⁴¹

(c) SALES BY AUCTION

Section 56 of the Ontario Sale of Goods Act codifies some important common law rules involving sales by auction. The section reads as follows:

In case of a sale by auction,

- (a) where goods are put up for sale in lots, each lot is *prima facie* the subject of a separate contract of sale;
- (b) a sale is complete when the auctioneer announces its completion by the fall of a hammer or in any other customary manner, and until such announcement is made any bidder may retract his bid;
- (c) where a sale is not notified to be subject to a right to bid on behalf of the seller, it is not lawful for the seller to bid himself or employ a person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person, and any sale contravening this rule may be treated as fraudulent by the buyer;
- (d) a sale may be notified to be subject to a reserved or upset price, and a right to bid may also be reserved expressly by or on behalf of the seller;
- (e) where a right to bid is expressly reserved, but not otherwise, the seller, or any one person on his behalf, may bid at the auction.

⁴⁰(1968), 404 F. 2d 505, discussed in Duesenberg and King, footnote 23 *supra*, at pp. 3-79 *et seq.*

⁴¹See, Draft Bill, Section 4.2(3).

With one important addition, the *Uniform Sales Act* substantially reproduced the British provisions, upon which section 56 of the Ontario Act is based. This addition, contained in section 21(2) of the *Uniform Sales Act*, involved the binding nature of an auction held without reserve. Section 2-328 of the Code has retained this addition and made several other changes. The section reads:

- (1) In a sale by auction if goods are put up in lots each lot is the subject of a separate sale.
- (2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling.
- (3) Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale. In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case a bidder may retract his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.
- (4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale.

The important differences between the Code provision and section 56 are the following:

- (1) Section 2-328(2) provides that, where a bid is made while the hammer is falling in acceptance of a prior bid, the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling;
- (2) The last sentence of section 2-328(3) provides expressly that retraction of a bid does not revive any previous bid;
- (3) Under the Code, it is specifically provided that, unless goods are expressly stated to be put up without reserve, a sale is deemed to be with reserve;⁴²
- (4) The binding nature of an auction without reserve, previously declared in section 21(2) of the *Uniform Sales Act*, is reaffirmed;⁴³

⁴²See, UCC 2-328(3), 1st sentence.

⁴³See, UCC 2-328(3), 3rd sentence.

- (5) Where the seller has made an undisclosed bid, the buyer's options are enlarged: he may either avoid the sale or "take the goods at the price of the last good faith bid prior to the completion of the sale";⁴⁴ and,
- (6) The rule forbidding the seller to participate in the bidding without disclosure does not apply to a forced sale.⁴⁵

The first difference deals with an esoteric question which, so far as we have been able to ascertain, has not led to any reported litigation in England or Canada. We do not, therefore, see any justification for copying this feature of UCC 2-328. The second difference, while not found in section 56, is declaratory of the common law⁴⁶ and could, we think, be usefully adopted. The third difference, if in fact there is a difference, raises a point of policy. A literal reading of section 56(d) of the Ontario Act might lead to the inference that the burden rests on the auctioneer to make clear whether the sale is with or without reserve and that, if nothing is said, it will be assumed to be without reserve. This inference is not justified, and section 56(d) is in fact concerned with a very different question: namely, whether there is a binding sale where the auctioneer has accepted a bid below the reserve price.⁴⁷ Even in the absence of a reserve price, the accepted rule⁴⁸ is that the auctioneer does not promise to accept the highest bid except, possibly, where the auction sale is advertised as being "without reserve". UCC 2-328(3) codifies this common law rule.

We have considered whether the rule should be reversed and a statutory presumption introduced that an auction is deemed to be without reserve unless the contrary is indicated. We have been persuaded, however, that such a presumption could cause hardship in the case of a non-professional auctioneer, as, for example, a farmer disposing of surplus goods, who might not be familiar with the new statutory rule. We do not, therefore, recommend any change in the law on this point, and our Draft Bill codifies the common law rule.⁴⁹

The fourth difference relates to the binding character of a promise to hold an auction without reserve. We support the Code provision in this respect. The common law position is unsettled⁵⁰ and legal scholars have debated whether consideration exists to support the enforceability of such a provision.⁵¹ Section 2-328(3) gives a welcome quietus to these doubts.

⁴⁴See, UCC 2-328(4).

⁴⁵*Ibid.*, last sentence.

⁴⁶Treitel, *The Law of Contract* (4th ed., 1975), p. 8.

⁴⁷*McManus v. Fortescue*, [1907] 2 K.B. 1 (C.A.).

⁴⁸As implied from *Warlow v. Harrison* (1859), El. and El. 295, 120 E.R. 920 (Exch. Ch.), and the rule that a request for bids is only an invitation to treat: *British Car Auctions Ltd. v. Wright*, [1972] 1 W.L.R. 1519 (Q.B.).

⁴⁹Two of the Commissioners, the Honourable Richard A. Bell and the Honourable J. C. McRuer, dissent from this recommendation. They would reverse the rule and provide that all auctions shall be deemed to be without reserve unless the contrary is indicated.

⁵⁰See Treitel, footnote 46 *supra*, pp. 91-92; and compare, *Holder v. Jackson* (1862), 11 U.C.C.P. 543, 546, *per Draper, C.J.*

⁵¹See the discussion between Slade and Gower in "Auction Sales of Goods without Reserve" (1952), 68 L.Q.R. 238, 457 and (1953), 69 L.Q.R. 21; and Hickling, "Auctions without Reserve" (1970), 5 U.B.C. L. Rev. 187.

Section 2-328(4), which contains the fifth difference, gives rise to greater difficulties. Section 56(c) of *The Sale of Goods Act* allows the deceived buyer to treat the seller's undisclosed bid as a fraudulent act, but nothing is said about the remedies open to a buyer in such a case. The purpose of the Code provision appears to be to facilitate the quantification of the buyer's damages.⁵² This may be regarded as a desirable goal, but it is not clear how the statutory formula would work in practice. There are constructional difficulties inherent in the section.⁵³

Given these difficulties, we do not feel it would be wise to copy this feature of section 2-328. We do, however, favour some clarification of the buyer's rights where the seller has made a secret bid. The case law entitles the buyer to avoid the sale,⁵⁴ but apparently there is no authority entitling him to affirm the contract and claim damages, or to claim damages even though he has avoided the sale. In principle we see no reason why he should not be entitled to claim damages in both types of case, and we so recommend.⁵⁵ We also favour allowing the buyer to recover damages in the form of an abatement in the price where he has not yet paid for the goods.

We turn, finally, to the sixth difference; that is, the exception to the prohibition against a seller's secret bid recognized in section 2-328(4) in the case of a forced sale. We support this exception on the ground that since the owner of the goods has not requested their sale, he is not a

⁵²See, State of New York, *Report of the Law Revision Commission for 1955: Study of the Uniform Commercial Code*, Vol. 1, p. (444) (hereinafter referred to as the "NYLRC Study").

⁵³A learned commentator, Professor Honnold, basing himself on an earlier version of subsection (4), offers, in the NYLRC Study *supra*, the following example. Suppose that the bidding for an article between buyer, B, third party, T, and undisclosed seller, S, proceeds as follows:

B —	\$45
T —	\$50
S —	\$55
B —	\$60
S —	\$65
B —	\$70

Which of these bids constitutes "the last good faith bid prior to the completion of the sale"? Presumably it is B's bid at \$60, but would this reduction in the price adequately compensate B? B might argue that, but for S's intervention, he might have stood a better than average chance to obtain the article at \$55. A similar difficulty would arise if, in the above example, B and S had been the only bidders. B might then feel that the goods would have been his for \$45. On the other hand, the statutory formula could cause hardship to S if the following sequence of bids is assumed:

B —	\$45
T —	\$50
S —	\$55
B —	\$60

In this example, B's "last good faith bid prior to completion of the sale" occurred at \$45, but it would not appear to be right to allow him to retain the goods at this price. The difficulty could be overcome by reading the statutory word to encompass a good faith bid by *any* bidder, whether he is the ultimate buyer or another person. But this reading could create new anomalies.

⁵⁴See, for example, *Feaster Trucking Service, Inc. v. Parks-Davis Auctioneers, Inc.* (1973), 505 P. 2d 612 (Kan. Sup. Ct.).

⁵⁵See, Draft Bill, s. 4.5(9).

"seller" and that a bid by him does not involve the mischief present in a secret bid in a voluntary sale.

In the light of the foregoing discussion, the Commission recommends the adoption of the following provisions in place of section 56 of *The Sale of Goods Act*:

- 4.5.—(1) Where goods are put up for sale by auction in lots, each lot is the subject of a separate sale.
- (2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in any other customary manner.
- (3) A sale by auction is with reserve unless the goods are put up without reserve.⁵⁶
- (4) In an auction with reserve, the auctioneer may withdraw the goods at any time until he announces completion of the sale.
- (5) In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time.
- (6) In an auction with or without reserve the bidder may retract his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.⁵⁷
- (7) A right to bid may be reserved expressly by or on behalf of the seller.
- (8) Where a seller has not reserved the right to bid, it is not lawful, except in the case of a forced sale, for the seller to bid himself or to employ a person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person.
- (9) Where subsection 8 is contravened, the buyer may treat the sale as fraudulent and may avoid the sale and recover damages, or may affirm the sale and recover damages or claim an abatement in the price.

4. CONSIDERATION⁵⁸

The shortcomings of various facets of the law of consideration have long been the subject of adverse comment by courts, textwriters, and law

⁵⁶See the dissent by two Commissioners in footnote 49, *supra*.

⁵⁷One of the Commissioners, the Honourable Richard A. Bell, does not agree with this subsection and would wish it to read:

(6) In an auction with or without reserve, the bidder may retract his bid until the auctioneer's announcement of the completion of the sale, but the auctioneer may continue the sale with the bidding then starting with that of the next highest bidder who is prepared to renew his bid.

⁵⁸See, Myers, "The Law of Consideration", Research Paper No. II.2.

reform bodies. In 1937, the Sixth Interim Report of the Law Revision Committee⁵⁹ made a substantial number of proposals, several of which, if adopted, would change fundamentally the basis for the enforceability of promises. While sympathizing with many of the Committee's criticisms of the existing doctrine, we are of the view that a comprehensive review of the law of consideration should constitute the object of a separate study, and that a revised Sale of Goods Act should limit itself to those shortcomings that experience shows to be particularly important in the sales area. This is true of the role of consideration in connection with firm offers and the modification of contractual rights and duties. We therefore turn to consider these facets.

(a) FIRM OFFERS

It is elementary law that a promise to keep an offer open for acceptance for a prescribed or reasonable period is not binding unless supported by consideration or unless it is made under seal. It is also well settled Anglo-Canadian law that the doctrine of injurious reliance or promissory estoppel does not assist the offeree who has acted to his detriment in good faith reliance on the firm offer, because the doctrine can only be used as a shield and not as a sword.⁶⁰ The Law Revision Committee strongly criticized the rule as being opposed to sound commercial morality and recommended its reversal.⁶¹ In a recently published *Working Paper on Firm Offers*⁶² the English Law Commission has reached the same, albeit tentative, conclusion and has made some proposals of its own. We agree with both these bodies, and would only add that the binding character of firm offers is widely accepted in other legal systems⁶³ as well as in the Hague Uniform Law on Formation⁶⁴ and the revised version of that law prepared by UNCITRAL.⁶⁵ In the common law world, the common law rule has been reversed, *inter alia*, in New York's *General Obligations Law*,⁶⁶ as well as in UCC 2-205. We therefore turn our attention to the formulation of the rule making firm offers enforceable even though not supported by consideration.

The following precedents will serve as a useful basis for the questions that need to be answered:

***Uniform Commercial Code*, Section 2-205:**

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not

⁵⁹Law Revision Committee, *Sixth Interim Report (Statute of Frauds and the Doctrine of Consideration)* (1937), (Cmd. 5449); Myers, *supra*, pp. 46-47.

⁶⁰*Combe v. Combe*, [1951] 2 K.B. 215 (C.A.); *Combe v. Combe* did not involve a firm offer.

⁶¹*Supra*, footnote 59, para. 38.

⁶²Law Commission, Working Paper No. 60, *Firm Offers* (1975).

⁶³*Corbin on Contracts*, Vol. 1, sec. 46.

⁶⁴Article 5.

⁶⁵UNCITRAL, Eleventh Session, *Report of the Working Group on the International Sale of Goods on the Work of its Ninth Session*, A/CN.9/128, Annex 1, art. 10(2), Jan. 6, 1975.

⁶⁶N.Y. *General Obligations Law*, art. 5-1109 (McKinney).

revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

New York General Obligations Law, Article 5-1109:

Written irrevocable offer. Except as otherwise provided in section 2-205 of the uniform commercial code with respect to an offer by a merchant to buy or sell goods, when an offer to enter into a contract is made in a writing signed by the offeror, or by his agent, which states that the offer is irrevocable during a period set forth or until a time fixed, the offer shall not be revocable during such period set forth or until such time because of the absence of consideration for the assurance of irrevocability. When such a writing states that the offer is irrevocable but does not state any period or time of irrevocability, it shall be construed to state that the offer is irrevocable for a reasonable time.

Uniform Law on Formation, Article 5:

1. The offer shall not bind the offeror until it has been communicated to the offeree; it shall lapse if its withdrawal is communicated to the offeree before or at the same time as the offer.

2. After an offer has been communicated to the offeree it can be revoked unless the revocation is not made in good faith or in conformity with fair dealing or unless the offer states a fixed time for acceptance or otherwise indicates that it is firm or irrevocable.

3. An indication that the offer is firm or irrevocable may be express or implied from the circumstances, the preliminary negotiations, any practices which the parties have established between themselves or usage.

4. A revocation of an offer shall only have effect if it has been communicated to the offeree before he has despatched or has done any act treated as acceptance under paragraph 2 of Article 6.

It will be seen that the questions that arise for decision are the following: (i) Who should be bound? (ii) For what period? (iii) Should writing be a condition of enforceability? (iv) How explicit must be the language of the offer? (v) Can irrevocability be implied from usage or course of dealing? and, (vi) What remedies should be available? We shall address each of these questions in turn.

(i) *Who should be bound?* UCC 2-205 restricts its application to firm offers made by merchants. The New York provision, on the other hand, is not so restricted. The English Law Commission⁶⁷ favoured the Code approach on the ground that it is consistent with the higher duties imposed in the Sale of Goods Act on a merchant seller. It may be

⁶⁷Supra, footnote 62, paras. 30-31.

argued that this does not explain why a firm offer should not also bind a non-merchant seller or buyer, assuming it is made freely and without unfair advantage being taken of the offeror. We have not been presented with any evidence that firm offers, not supported by consideration, are a significant feature in non-merchant sale transactions. We can see the merit of the argument that firm offers should be enforceable without restriction as to the character of the offeror; but, in our view, this argument merits more detailed consideration, which may be undertaken in the context of a general reform of the law of consideration. We therefore support the Code position, and our Draft Bill so provides.⁶⁸ We would stress that this recommendation is not intended to preclude further study of the whole problem by the Law of Contract Amendment Project.

(ii) *For what period?* Comment 2 to section 2-205 of the *Uniform Commercial Code* justifies restricting the binding character of a firm offer to three months on the ground that the section was intended to apply to current firm offers and not to long term options. In the case of offers for a specified period, the English Law Commission was of the view that a short period could be a trap for the unwary; but they also felt that it would be inconvenient for offerors and their executors to be bound for very long periods of time. The Law Commission favoured⁶⁹ a cut-off point corresponding to the limitation period for bringing an action founded on simple contract, that is, six years, with the result that "a promise of non-revocation that was expressed to run for a longer period should cease to be binding after six years". We have reached a somewhat different conclusion. It appears to us that a merchant is quite capable of determining his own best interest, and that he should be free to set his own period of time, whether it is for more or less than six years. A firm offer that was expressed to remain open for more than six years would no doubt be a very unusual occurrence, but we see no overriding public policy that militates against its effectiveness. If it has been procured by improper means, the problem can be dealt with under other heads. Again, we see no justification, in terms of its effective duration, in drawing a distinction between a firm offer supported by consideration and an offer made without consideration. In the light of these factors, we have concluded that the revised Act should not impose a limit on the effectiveness of an offer expressed to remain open for a specified period, and so recommend.

With respect to firm offers for an unspecified period, the Law Commission's Working Paper takes yet another approach. The Law Revision Committee was of the view that a firm offer for an unspecified period should not fall within the rule making firm offers enforceable even though not supported by consideration. The Working Paper reaches the same conclusion on the ground that "the need for certainty outweighs the other considerations".⁷⁰ We are not persuaded by this reasoning. It is well settled law that a simple offer is open for acceptance for a reasonable period, unless the offer provides otherwise. It is difficult to see why

⁶⁸See, Draft Bill, s. 4.3.

⁶⁹Law Commission, Working Paper No. 60, *Firm Offers* (1975), paras. 32-33.

⁷⁰Ibid., para. 34.

a different rule of construction should be applied to firm offers, or why it should create greater uncertainty than in the case of ordinary offers. As will have been noted, neither the Code nor, it would seem, the Uniform Law on Formation distinguishes, in this context, between firm offers for a stated duration and firm offers for an unspecified period. Nevertheless, in order to accommodate, to some extent, the Law Commission's apprehensions, we recommend that, where the offer states no time for its duration, it shall remain irrevocable for a reasonable time not to exceed three months.⁷¹

(iii) *Should writing be a condition of enforceability?* This question is answered affirmatively both in the Code and in the New York provisions. The English Law Commission's Working Paper on *Firm Offers*, however, reaches the opposite conclusion⁷² on the grounds of hardship to a non-business person, who might not appreciate the importance of obtaining the offer in writing or might be unwilling to press for a written offer. A majority of this Commission⁷³ agrees with the English Law Commission. We have, however, adopted this position on grounds that are broader than those stated by the Law Commission. As will be seen below, we favour the abolition of a Statute of Frauds requirement for sales contracts in general.⁷⁴ The only meaningful distinction that can be drawn between the evidentiary requirements for the enforcement of a sales contract and the enforcement of a firm offer, is the presence of consideration in the first case and the absence of it in the second. However, this distinction disappears once it is appreciated that the offeror usually has a sound business reason for his willingness to make the firm offer, or that he may be following an established business practice. It might be argued that writing could also be regarded as a substitute for consideration; this reasoning appears, at least in part, to underlie the Code requirement in the case of firm offers⁷⁵ and is influenced by the fact that many American jurisdictions have abolished the use of seals. Whether writing should serve this office in the law of consideration raises an important question well outside our terms of reference and we do not pursue it here.

(iv) *How explicit must be the language of the offer?* Section 2-205 of the Code refers to an offer which by its terms "gives assurance" that it will be held open. Apparently the quoted words were intended⁷⁶ to convey the requirement of an open offer made with serious intent. The intention to enter into a legally enforceable bargain is a prerequisite to all offers, and we do not think it has to be spelled out separately.

⁷¹See, Draft Bill, s. 4.3.

⁷²*Supra*, footnote 69, paras. 35-38.

⁷³Two of the Commissioners, the Honourable J. C. McRuer and Mr. W. Gibson Gray, dissent from the views of the majority and would require firm offers not supported by consideration to be in writing.

⁷⁴*Infra*, this chapter, section 6.

⁷⁵Compare, *Restatement of the Law, Contracts 2d*, footnote 12 *supra*, s. 89B, Comment d.

⁷⁶See, UCC 2-205, Comment 2.

We believe it sufficient to say that the offer must "expressly" provide that it will be held open for acceptance, and we so recommend.

(v) *Can irrevocability be implied from usage or course of dealing?*

The requirement of an explicit promise necessarily leads to the conclusion⁷⁷ that a promise implied from the surrounding circumstances cannot constitute a firm offer enforceable in the absence of consideration. The English Law Commission was of the view⁷⁸ that an attempt to distinguish between express and implied promises would cause more difficulties than it prevented. Moreover, we recognize that the distinction is not drawn in the Uniform Law. Nevertheless, we favour an incremental approach, and therefore recommend no change in the Code precedent until such time as a complete review has been undertaken of the role of consideration in our law.

(vi) *What remedies should be available?* It will be obvious from the preceding discussion that a firm offer that meets the requirements of the revised Act gives rise to a contractual obligation.⁷⁹ However, this characterization does not answer the question of the remedies that should be available to the aggrieved party where the offeror wrongfully repudiates the firm offer before its acceptance. This question is not explicitly answered in the American provisions, but is extensively canvassed in the English Law Commission's Working Paper.⁸⁰ The Working Paper points out that the alternatives are between treating the wrongful revocation as a nullity and treating it as a cause of action. If we interpret the Commission's reasoning correctly, they would favour giving the innocent party the right to elect either remedy on the ground that this corresponds to the remedies available in other cases of anticipatory repudiation of a contractual promise. We do not support this approach entirely. As will be seen from a later part of this Report,⁸¹ we favour the abolition of the doctrine of election with respect to anticipatory breaches. If this recommendation is adopted, consistency suggests similar treatment of the rights of the injured party where an offeror wrongfully revokes his offer. However, no separate provision is necessary to reach this result, since it will necessarily follow from the general provisions in the revised Act dealing with the consequences of acts of anticipatory repudiation.

In addition to the above questions, some reference should be made to the doctrine of injurious reliance. The Law Commission's Working Paper refers⁸² to this doctrine, which has been applied by some American courts to prevent revocation of an offer, not otherwise expressed to be irrevocable, where the offeror should have anticipated detrimental reliance on the offer by the offeree. A provision to this effect appears in section 89B of the Tentative Draft of the *Second Restatement on Con-*

⁷⁷Compare, *ibid.*, last sentence.

⁷⁸Law Commission, footnote 69 *supra*, para. 34.

⁷⁹See the definition of "contract" in s.1.1(1)7 of the Draft Bill.

⁸⁰Supra, footnote 69, paras. 41-50.

⁸¹Infra, ch. 18, section 4.

⁸²Supra, footnote 69, paras. 51-54.

tracts.⁸³ The doctrine has obvious merit but, once again, raises much broader issues that are more appropriately discussed in the context of a Law of Contract Amendment Project.

(b) CONTRACTUAL MODIFICATIONS

(i) *The Existing Position*

As the replies to the C.M.A. Questionnaire illustrate,⁸⁴ modifications made to the terms of the contract after its initial conclusion are quite common. The modifications may involve price, quantity, specifications or delivery dates. Among manufacturers, at least in normal times, modifications in the terms of delivery appear to head the list, but the frequency and types of modifications may well vary among other segments of the business community. In inflationary times, or in periods of shortages, the pressure for substantial modifications is particularly strong. One might have thought that the common law would have been content to respect a familiar business phenomenon without fettering it with the restrictive requirements of the doctrine of consideration. Such an attitude could reasonably be justified in terms of the difference between requiring consideration to support the enforceability of an original promise, and recognizing a freely and fairly adopted modification once the bargain has been struck.⁸⁵

In fact, subject to the statutory and common law exceptions to be mentioned below, our law draws no such distinction. Instead we have the rule in *Pinnel's Case*,⁸⁶ and the equally well entrenched doctrine

⁸³Section 89B provides:

- (1) An offer is binding as an option contract if it
 - (a) is in writing and signed by the offeror, recites a purported consideration for the making of the offer, and proposes an exchange on fair terms within a reasonable time; or
 - (b) is made irrevocable by statute.
- (2) An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice.

⁸⁴See, Fisher, Research Paper No. I.2, Part IV, pp. 35-37.

⁸⁵As the New Hampshire court observed in *Watkins & Son, Inc. v. Carrig* (1941), 21 A. 2d 591, (see, Duesenberg & King, footnote 23 *supra*, p. 4-34, n. 9):

. . . In common understanding there is, importantly a wide divergence between a bare promise and a promise in adjustment of a contractual promise already outstanding. A promise with no supporting consideration would upset well and long-established human inter-relations if the law did not treat it as a vain thing. But parties to a valid contract generally understand that it is subject to any mutual action they may take in its performance. Changes to meet changes in circumstances and conditions should be valid if the law is to carry out its function and service by rules conformable with reasonable practices and understandings in matters of business and commerce.

⁸⁶(1602), 5 Co. Rep. 266, 77 E.R. 1177 (K.B.). The rule is that a seller is not bound by a promise to accept part payment in satisfaction of a debt. But payment of a lesser sum at a different place or at an earlier time or by a different method will discharge the debt, if made for the benefit of the seller: See, *Benjamin's Sale of Goods* (1974), para. 691. See, also, Myers, Research Paper No. II.2, pp. 25 *et seq.*

that a promise in exchange for a promise to perform an existing contractual duty owing to the promisor is unenforceable if not supported by consideration.⁸⁷ This requirement of consideration is subject to the following exceptions:

(1) *The doctrine of waiver.* This doctrine is of common law origin and its precise boundaries are unclear.⁸⁸ Its mitigating effects appear, however, to be restricted to modifications involving the mode of performance, and do not include a change or abandonment of the parties' substantive rights. Moreover, a waiver has no contractual effect and can be retracted if reasonable notice is given to the party for whose benefit it was originally granted.

(2) *The doctrine of promissory or equitable estoppel.* The origins of this equitable doctrine are usually traced to the decision of the House of Lords in *Hughes v. Metropolitan Railway Co.*⁸⁹ The doctrine remained largely dormant, however, until it was revived by Denning, J., as he then was, in his well-known judgment in *Central London Property Trust Ltd. v. High Trees House, Ltd.*⁹⁰ The doctrine provides that a promise intended to modify legal relationships, including of course contractual relationships, intended to be acted upon and in fact acted upon, will bind the promisor until he gives notice of the retraction of his promise. The doctrine, therefore, has some serious limitations. First, it does not create a new cause of action where none existed before. It is a defensive shield and not an offensive sword.⁹¹ As a result the doctrine does not assist the plaintiff in the "duty" cases,⁹² as, for example, where a seller seeks to enforce a buyer's promise to pay more than was agreed upon in the original contract. Secondly, the doctrine is probably only suspensory in character and does not preclude the promisor from changing his mind, even though his initial promise may have been unqualified.⁹³ Thirdly, although the point is not beyond doubt, it appears that the promisee must be able to show detrimental reliance on the promise.⁹⁴

⁸⁷Myers, *supra*, pp. 18-20; and see now, also, *Gilbert Steel Ltd. v. University Construction Ltd.*, [1973] 3 O.R. 268, 36 D.L.R. (3d) 496 (H.C.J.), aff'd (1976), 12 O.R. (2d) 19, 67 D.L.R. (3d) 606 (C.A.). See, also, Reiter, "Courts, Consideration and Common Sense" (1977), 27 U.T.L.J. 439.

⁸⁸Benjamin, footnote 86 *supra*, paras. 878-79; Treitel, footnote 46 *supra*, pp. 75-77; *Hartley v. Hymans*, [1920] 3 K.B. 475; *Charles Rickards Ltd. v. Oppenheim*, [1950] 1 K.B. 616 (C.A.).

⁸⁹(1877), 2 A.C. 439.

⁹⁰[1947] K.B. 130; see, also, Myers, Research Paper No. II.2, pp. 32 *et seq.*

⁹¹*Combe v. Combe*, [1951] 2 K.B. 215 (C.A.). See, also, *Tudale Exploration Limited v. Bruce and Teck Mining Group Limited* (1978), 20 O.R. (2d) (Div. Ct.).

⁹²Duty cases are those cases where a plaintiff contracting party seeks to enforce a promise by the other contracting party to vary the terms of the contract to the plaintiff's advantage if he, the plaintiff, will perform his existing contractual obligations.

⁹³See, Chitty, *The Law of Contracts* (24th ed., 1977), Vol. I, paras. 198 *et seq.*, and Treitel, footnote 46 *supra*, p. 78. But see, Cheshire and Fifoot, *The Law of Contract* (8th ed., 1972), at p. 90, and Fridman, *The Law of Contract in Canada* (1976), at p. 193, n. 51, which suggest that the question of whether promissory estoppel suspends or abrogates the promisor's legal rights is still the subject of controversy.

⁹⁴Treitel, footnote 46 *supra*, pp. 79-80.

(3) *The Mercantile Law Amendment Act, section 16.* This provision was first enacted in 1885 as section 6 of *The Administration of Justice Act*⁹⁵ and was intended to relieve against the hardship of the rule in *Pinnel's Case*. Section 6 now appears as section 16 of *The Mercantile Law Amendment Act*⁹⁶ and reads as follows:

Part performance of an obligation either before or after a breach thereof when expressly accepted by the creditor in satisfaction or rendered in pursuance of an agreement for that purpose, though without any new consideration, shall be held to extinguish the obligation.

A substantially similar provision has been adopted in the laws of the four Western Provinces.⁹⁷ The section has generated only a sparse volume of litigation⁹⁸ and would appear to raise the following questions. First, it remains unsettled whether the section covers all forms of obligation or is restricted to monetary debts. All the reported cases⁹⁹ have involved pecuniary obligations, and the use of the word "creditor" in line 2 of section 16 supports the restrictive reading of "obligation" in line 1. Secondly, there is a slender doubt whether "an agreement" to accept a lesser sum in satisfaction of the contractual debt must itself be supported by consideration. There is some authority¹⁰⁰ to support the doubt but the better view is that consideration is unnecessary. The third question involves a more serious doubt:¹⁰¹ namely, whether the promisor is free to resile from his agreement before the part performance has been fully executed by the promisee. Finally, a literal reading of the section suggests that it cannot be invoked where a complete waiver, and not a partial dispensation from performance, is alleged. If this is correct, section 16 is not as comprehensive in its operation as the doctrine of promissory estoppel. On the other hand, to the extent that an agreement to accept part performance is binding *per se* and cannot be retracted, the statutory provision is more favourable to the promisee than this equitable doctrine.

(4) *Modifications made under seal.* This exception requires no separate discussion except to note its formalistic and impractical nature in the context of everyday business relationships.

The effect of the above enumerated exceptions may be summarized as follows. The first three offer only partial relief from the normal requirement of consideration. Important types of modifications remain untouched, particularly those involving the so-called "duty" cases. Only

⁹⁵48 Vict., c. 13, (Ont.).

⁹⁶R.S.O. 1970, c. 272.

⁹⁷See, *The Mercantile Law Amendment Act*, R.S.M. 1970, c. M 120, s. 6; *The Judicature Act*, R.S.A. 1970, c. 193, s. 34(8); the *Laws Declaratory Act*, R.S.B.C. 1960, c. 213, s. 34; *The Queen's Bench Act*, R.S.S. 1965, c. 73, s. 45.7.

⁹⁸See the discussion in Waddams, *The Law of Contracts* (1977), p. 92.

⁹⁹See, *Bank of Commerce v. Jenkins* (1888), 16 O.R. 215 (C.P.D.); *Mason v. Johnston* (1893), 20 O.A.R. 412 (C.A.); *Champlain Ready-Mixed Concrete v. Beaupre*, [1971] 3 O.R. 568 (C.A.).

¹⁰⁰See, Gregory, J., in *Bell v. Quagliotti* (1918), 25 B.C.R. 460 (S.C.).

¹⁰¹See, Waddams, footnote 98 *supra*, p. 92, n. 302.

the use of a seal avoids these difficulties, but the formalities of a sealed document, though now liberally interpreted, are still sufficiently significant to undermine its utility in the sales context.

(ii) *Proposals for Change*

Several of the recommendations in the Report of the English Law Revision Committee¹⁰² were specifically designed to relieve against the rigidities of the consideration requirement with respect to contractual modifications. Recommendation 3¹⁰³ sought to abolish the rule in *Pinnel's Case*. Recommendation 4¹⁰⁴ addressed itself to the duty cases, while Recommendation 8 would have resulted in the adoption of a broad doctrine of injurious reliance comparable to section 90 of the American *Restatement on Contracts*, and much more far-reaching in its impact than the existing doctrine of equitable estoppel.

None of the Committee's recommendations has so far been implemented in the United Kingdom. It seems, therefore, appropriate to look elsewhere for suitable precedents. The *Uniform Commercial Code* provides two models which deserve serious consideration. The first is represented by section 1-107, which provides that:

Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

The section has a relatively narrow compass.¹⁰⁵ It was designed as a general Code rule and not with a view to meeting the particular needs of contractual modifications in the sales area. This function was reserved to section 2-209, which reads:

- (1) An agreement modifying a contract within this Article needs no consideration to be binding.
- (2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.
- (3) The requirements of the statute of frauds section of this Article

¹⁰²Supra, footnote 59.

¹⁰³Recommendation 3 is as follows:

That an agreement to accept a lesser sum in discharge of an enforceable obligation to pay a larger sum shall be deemed to have been made for valuable consideration, but if the new agreement is not performed then the original obligation shall revive.

¹⁰⁴Recommendation 4 is as follows:

That an agreement in which one party makes a promise in consideration of the other party doing or promising to do something which he is already bound to do by law or by a contract made either with the other party or with a third party, shall be deemed to have been made for valuable consideration.

¹⁰⁵Compare, NYLRC Study, footnote 52 *supra*, pp. (202) *et seq.*

(Section 2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

Comment 1 to the section explains that its purpose is "to protect and make effective all necessary and desirable modifications of sales contracts without regard to the technicalities which at present hamper such adjustments".

It will be observed that conceptually section 2-209 operates at two different levels.¹⁰⁶ Subsection (1) proceeds on an obligational theory and enforces the modified terms because the parties have agreed that it should be so. Subsections (4) and (5) are based, it would seem, on a qualified theory of injurious reliance or promissory estoppel and only give effect to a modified term, not supported by consideration, where it amounts to a waiver and it would be unjust to allow the promise to be retracted. Waiver is not defined in the Code,¹⁰⁷ but in its literal and traditional sense only encompasses the relinquishment of rights and not the assumption of new obligations. Presumably, therefore, a promisee could not invoke subsection (4) to enforce payment of a higher sum than that called for in the original contract, even though he had altered his position in reliance on the promise.¹⁰⁸ In practice, promisees will no doubt prefer to rely on subsection (1) unless they are precluded from doing so by the provisions of subsections (2) or (3).

A traditional policy objection¹⁰⁹ to allowing a contracting party to enforce a promise given in exchange for performance of an existing obligation has been the fear that it would encourage the extortion of unjustified concessions; the requirement of consideration has been seen as a partial bulwark against such behaviour. The Code draftsmen anticipated this danger and Comment 2 to section 2-209 makes it clear that the requirement of good faith will apply here, as elsewhere, and that "the extortion of a 'modification' without legitimate commercial reason

¹⁰⁶For a detailed analysis of its provisions, see NYLRC Study, footnote 52 *supra*, pp. (640) *et seq.*; and compare, Duesenberg and King, footnote 23 *supra*, pp. 4-34 *et seq.*

¹⁰⁷Compare, Duesenberg and King, footnote 23 *supra*, p. 4-46.2, and NYLRC Study, footnote 52 *supra*, pp. (644)-(647).

¹⁰⁸But see, *contra*, *West Point-Pepperell, Inc. v. Bradshaw* (1974), 377 F. Supp. 154 (M.D. Ala.), criticized in Duesenberg and King, footnote 23 *supra*, (March, 1978 Cum. Supp.), at p. 71; and *Thomas Knutson Shipbuilding Corp. v. George W. Rogers Constr. Corp.* (1969), 6 U.C.C. Rep. Serv. 323 (N.Y. Sup. Ct.), summarized in Duesenberg and King, footnote 23 *supra*, (March, 1978 Cum. Supp.), at pp. 71-72.

¹⁰⁹See, Treitel, footnote 46 *supra*, pp. 65-66.

is ineffective as a violation of the duty of good faith". As the cases show,¹¹⁰ what is a "legitimate" commercial reason may not always be easy to answer. However, this uncertainty is endemic in the concept of good faith. Further, an Act that is designed to cover a vast variety of transactions cannot be expected to become particularistic without defeating its own purpose. What is important, in our view, is that the law should not frustrate reasonable and legitimate commercial practices. We therefore recommend the abolition of the need for consideration to support an agreement made in good faith modifying the terms of an existing contract, and our Draft Bill so provides.¹¹¹

Two other issues need to be considered in conjunction with such a provision. The first is whether a court should be empowered to refuse to enforce a modification, not only on the ground of the promisee's bad faith, but also on the ground of its unconscionability. Arguably, in the context of a section 2-209 provision, the two tests overlap; but, to the extent that there remains a difference, our answer would be in the affirmative. However, there is no need to say this expressly since, as is explained later,¹¹² we favour the adoption of a general unconscionability rule along the lines of UCC 2-302. This rule would apply to all contractual provisions, whether original or modified.

The second issue is whether the modified term must be reduced to writing as a condition of its enforceability. Section 2-209 imposes such a requirement in two instances: (a) where the modified contract falls within the Statute of Frauds provisions of Article 2;¹¹³ and, (b) where the contract contains a "private" Statute of Frauds provision such as is frequently found in standard form agreements. The second feature is essentially declaratory¹¹⁴ and we have no objection to its adoption in the revised Act, although, in common with others,¹¹⁵ we are sceptical about the value of requiring a separate signature where the clause appears in an agreement between a merchant and a non-merchant.

The Commission is divided on the question,¹¹⁶ but a majority of us are opposed to a general writing requirement as a condition of the enforceability of contractual modifications. Later in this chapter, we recommend repeal of the existing Statute of Frauds provision in the Ontario Act.¹¹⁷ In our view, it would be inconsistent to retain the requirement for

¹¹⁰For example, *Ralston Purina Co. v. McNabb* (1974), 381 F. Supp. 181 (D.C. Tenn.); *Ruble Forest Products, Inc. v. Lancer Mobile Homes of Oregon, Inc.* (1974), 524 P. 2d. 1204 (Ore. Sup. Ct.). Compare, *North Ocean Shipping Co. Ltd. v. Hyundai Construction Co. Ltd.*, "The Atlantic Baron", [1978] 3 All E.R. 1170 (Q.B.).

¹¹¹See, Draft Bill, s. 4.8(1).

¹¹²*Infra*, ch. 7, Part A.

¹¹³See, UCC 2-201.

¹¹⁴Apparently, pre-Code cases such as *Green v. Doniger* (1949), 90 N.E. 2d 56 (N.Y.C.A.), held such clauses unenforceable. UCC 2-209(2) was designed to restore the parties' intention.

¹¹⁵For example, *Duesenberg and King*, footnote 23 *supra*, p. 4-34.

¹¹⁶Two of the Commissioners, the Honourable J. C. McRuer and Mr. W. Gibson Gray, are of the view that a written agreement should be capable of modification only in writing.

¹¹⁷See *infra*, this chapter, section 6.

some purposes and not for others. We have found no evidence that simulated oral variations constitute a greater threat than original agreements concluded orally; the traditional concerns have been with respect to modifications procured by unfair means, and these we have attempted to meet.

To the extent that a private "Statute of Frauds" provision, or perhaps a writing requirement imposed under another Act, precludes *per se* enforcement of the modified agreement, the doctrines of waiver and equitable estoppel will retain their relevance. Subject to what we say hereafter, this should be made clear in the revised Act. As we have previously noted, UCC 2-209(4) and (5) only refer to a "waiver". We have added a specific reference to equitable estoppel to the corresponding provisions in the Draft Bill to make it clear that they apply to waiver of substantive obligations, as well as to compliance with procedural requirements.¹¹⁸

We conclude with a brief note on section 16 of *The Mercantile Law Amendment Act*. Where a modified agreement is enforceable under our earlier recommendation, as well as under this section, the enforcing party may have a choice of avenues. However, in cases not involving a contract of sale, he will not have a similar choice. This alone is sufficient reason for its retention. As we have indicated previously, the section requires clarification in several respects. We are, however, content to leave this task to the Law of Contract Amendment Project.

(c) SHOULD THE EFFECT OF SEALS BE ABOLISHED?¹¹⁹

UCC 2-203 provides that:

The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer.

We do not recommend adoption of such a provision in the revised Ontario Act. The purpose of the section, as its language and Comment 1 make clear, is to deprive a seal of any special effect that its use would otherwise have at common law on a contract of sale or an offer to buy or sell. However, the result is not as radical as may appear at first sight since, as has been seen, Article 2 goes a long way towards remedying the defects in the prior law of consideration and, as a result, few advantages would remain in the use of a seal in sale transactions, even assuming businessmen could be expected to be aware of them. However, the abolition of the effect of a writing under seal would still make a difference; for example, with respect to the binding character of a firm offer for an unspecified period made without consideration, where the offeree purports to accept the offer after a period of three months has elapsed.¹²⁰ The adoption of a section similar to UCC 2-203 would also raise important questions with respect to the role and effectiveness of sealed writings in other branches of the law. We think it better, therefore, that any change in the law of

¹¹⁸See, Draft Bill, s. 4.8(3) and (4).

¹¹⁹See, Waddams, "Sealed Contracts in the Sale of Goods", Research Paper No. II.9A.

¹²⁰See, *supra*, this ch., at p.94.

sealed writings should await the outcome of a comprehensive review of the doctrine of consideration and the enforceability of gratuitous promises.

5. MISTAKE

Another important area of general contract law that gives rise to recurring difficulties is that of mistake. The doctrine of mistake was the subject of a separate research paper prepared for the Commission.¹²¹ As noted in the paper,¹²² the operative effect of mistake on the formation and enforceability of a contract has generated intense discussion among legal scholars. There is, however, little agreement concerning important issues, including the following: namely, the proper role of mistake in contract law; the present state of the law; the nature of the problems; or, the manner in which they should be resolved. This lack of agreement might suggest a fertile field for law reform. However, most of the basic issues are neither peculiar to sales law, nor more important in their practical impact on the law of sales than on other branches of contract law. We agree with the conclusion reached in the research paper that a comprehensive review of the general principles of the law of mistake can only be undertaken in the context of their relationship to other questions of contract law.

We turn now, however, to a consideration of two facets of the law that are expressly or inferentially regulated in the existing Act. Thereafter, we will indicate our reaction to the more generalized recommendations contained in the research paper.

(a) RES EXTINCTA

Sections 7 and 8 of *The Sale of Goods Act* provide as follows:

7. Where there is a contract for the sale of specific goods and the goods without the knowledge of the seller have perished at the time the contract is made, the contract is void.

8. Where there is an agreement to sell specific goods and subsequently the goods without any fault of the seller or buyer perish before the risk passes to the buyer, the agreement is thereby avoided.

It will be convenient to postpone discussion of section 8, which deals with casualty to goods after their identification to the contract, to the chapter of this Report dealing with frustration of the contract of sale.¹²³ Some discussion of section 7 is, however, in our view, useful at this stage.

Section 7 is based on the effect that was for a long time ascribed to the decision of the House of Lords in *Couturier v. Hastie*.¹²⁴ Its statutory formulation raises several important questions of construction and a basic issue of principle. The constructional issues will be mentioned briefly.¹²⁵ Section 7 only applies to goods that have perished. It does not

¹²¹John D. McCamus, "Mistake in Contracts for the Sale of Goods", Research Paper No. II.8.

¹²²*Ibid.*, p. 1.

¹²³See, *infra*, ch. 15.

¹²⁴(1856), 5 H.L. Cas. 673, 10 E.R. 1065.

¹²⁵See, McCamus, footnote 121 *supra*, pp. 32-36.

apply expressly to a case where the goods have never existed, have disappeared, or have been disposed of prior to the contract of sale. Nor is the requirement of perishment apt to describe goods that have deteriorated seriously in quality, but still retain a physical existence. There is a further point. The words "specific goods" are defined in section 1(1)(m) to mean "goods identified and agreed upon at the time the contract of sale is made". Accordingly, it is not clear to what extent section 7 applies to partly perished goods or to goods to be derived from an agreed source of supply that has failed. Finally, the section is markedly silent on the effect of the seller's negligence in failing to know the true position before entering into the contract of sale.

The broad issue of principle raised by section 7 may be stated in this way: it is difficult¹²⁶ to reconcile the section with the general conceptual framework of the Act and, in particular, with later provisions¹²⁷ that impose upon the seller implied obligations with respect to his title and the merchantability and fitness of the goods sold by him. It seems clear, in the absence of special circumstances or an effective disclaimer clause, that a mistaken assumption by the parties with respect to the implied warranties will not excuse the seller. Except in historical terms, it is not easy to explain why a different rule should be applied when the seller's mistake involves the existence of the goods, rather than his title to, or the proper attributes of, the goods. *Couturier v. Hastie* was distinguished by the High Court of Australia in its well known decision in *McRae v. Commonwealth Disposals Commission*.¹²⁸ Further, several learned authors have suggested¹²⁹ that section 7 does not state an inflexible rule, but merely gives rise to a presumption, in the cases to which it applies, that the seller is not contracting that the goods exist.

The Code's counterpart to sections 7 and 8 is section 2-613. This section provides:

Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a 'no arrival, no sale' term (Section 2-324) then

- (a) if the loss is total the contract is avoided; and
- (b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller.

It will be noted that the section collapses the distinction between the effect of frustrating events subsequent to the formation of the contract and a

¹²⁶Compare, Atiyah, *The Sale of Goods* (5th ed., 1975), p. 40.

¹²⁷*The Sale of Goods Act*, ss. 13-15.

¹²⁸(1951), 84 C.L.R. 377.

¹²⁹For example, Atiyah, footnote 126 *supra*, p. 43; *Benjamin's Sale of Goods* (1974), para. 123.

mistaken assumption with respect to the existence of the goods at the time of contracting, and treats them as two sides of the same coin. It will be seen, too, that the section resolves some, but not all, of the constitutional questions presented by section 7. The issue of principle, however, only surfaces in Comment 2 which, after referring to the case in which the risk has passed to the buyer before casualty, continues as follows:

Beyond this, the essential question in determining whether the rules of this section are to be applied is whether the seller has or has not undertaken the responsibility for the continued existence of the goods in proper condition through the time of agreed or expected delivery.

It is not clear whether this qualification is only meant to apply to frustrating events occurring subsequent to the time of sale. Assuming it is not, it may be objected that, if section 2-613 was only intended to operate as a presumptive rule, this should have been stated clearly and not buried in a Comment. Apart from this feature, it appears from another part of the official annotation that the Code provisions were not intended to change the basic policy of sections 7 and 8 of the *Uniform Sales Act*, which in turn were based on sections 6 and 7 of the U.K. Act, the precursors of sections 7 and 8 of the Ontario Act.

What then should be the policy of the revised Ontario Act? There are several possibilities. One is to retain the essential structure of section 7 of the existing Act, subject to correction of the technical defects that have been mentioned. A second possibility is to reject the conceptual basis of the section and to provide that the seller warrants the existence of the goods, unless the circumstances indicate the contrary. The third possibility is to adopt a compromise position, which would involve retention of the principle of the section, but which would make it clear that the rule can be rebutted by contrary indications and that, in any event, the seller will not be excused if he has behaved negligently. For reasons of continuity we favour the third course. Accordingly, the Commission recommends the adoption in Ontario, in place of section 7 of the existing Act, of a provision, similar to UCC 2-613, with respect to the effect of the parties' mistaken assumption as to the existence of the goods. The new section should, however, make it clear that its provisions can be rebutted by evidence of a contrary intention by the parties, and that the seller will not be excused from non-performance if he has behaved negligently. Our Draft Bill so provides.¹³⁰ We also see substantial merit in merging sections 7 and 8 of the existing Act, as has been done in UCC 2-613. In addition, there are a number of technical changes that we should like to see in our recommended version of UCC 2-613, and we deal with these matters in a later chapter¹³¹ devoted to the subject of frustration.

¹³⁰See, Draft Bill, s. 8.13.

¹³¹*Infra*, ch. 15.

(b) MISTAKES OF IDENTITY

It is well settled by a long line of decisions¹³² that a mistake by the seller with respect to the identity of the buyer, induced by the latter's fraud, will preclude the formation of a binding contract and entitle the seller to recover the goods in the hands of a third party. If, however, his mistake only goes to the buyer's attributes, the contract is voidable; in this event, a third party will obtain good title if the agreement has not been avoided before the goods have been acquired by him in good faith and for value. The difficulty is to determine what amounts to a mistake of identity and what is to be treated as a mistake about attributes. The cases are legion and often difficult to reconcile with one another. The author of the research paper prepared for the Commission on this topic¹³³ proposed to resolve the difficulty by abolishing the distinction between void and voidable titles and treating all mistakes involving the other contracting party as making the contract only voidable. A similar recommendation is contained in the Report of the Law Reform Committee on the Transfer of Title to Chattels.¹³⁴ This proposal is also in line with the rule adopted in UCC 2-403(1)(a). These developments will be discussed further in the chapter in this Report¹³⁵ on the operation of the *nemo dat* rule in sales law. The Commission has also considered a proposal¹³⁶ that would give the courts broad discretionary powers to allocate the loss resulting from the buyer's fraud between the seller and the third party. This suggestion, too, will be examined in the later chapter. For the moment it will suffice to say that we support the first proposal but have some reservations about the second.

(c) WIDER PROPOSALS FOR REFORM

In addition to these relatively modest changes the research paper mentioned above contained the following much more significant recommendations¹³⁷ for the clarification and recasting of existing mistake rules:

- (1) all operative mistakes should be treated as voidable or equitable in character and flexible remedies permitting recovery of restitutionary and reliance losses and their apportionment should be adopted;
- (2) the distinction between mistakes of fact and mistakes of law should be eliminated;
- (3) the doctrine of mistake based upon erroneous common assumptions should be supported. The rules should be codified and an

¹³²See, for example, *Hardman v. Booth* (1863), 158 E.R. 1107 (Exch.); *Cundy v. Lindsay* (1878), 3 App. Cas. 459 (H.L.); *Wilson v. Windsor Foundry Co.* (1901), 31 S.C.R. 381; *Lake v. Simmons*, [1927] A.C. 487 (H.L.); *Cuff-Waldron Mfg. Co. v. Heald*, [1930] 3 D.L.R. 901 (Sask. C.A.). Compare, *Lewis v. Averay*, [1972] 1 Q.B. 198 (C.A.).

¹³³McCamus, footnote 121 *supra*, p. 79, Recommendation 1.

¹³⁴Law Reform Committee, *Twelfth Report (Transfer of Title to Chattels)* (1966), (Cmnd. 2958), para. 15.

¹³⁵*Infra*, ch. 12.

¹³⁶McCamus, footnote 121 *supra*, pp. 79-80, Recommendation 2.

¹³⁷*Ibid.*, pp. 61, 79.

appropriate framework of criteria, based upon a previously devised formula¹³⁸ should be supported; and,

- (4) the distinction between common and unilateral mistaken assumptions should be abolished.

The Commission has not studied these proposals in detail, and expresses no view with respect to their merits. With the exception of cases of *res exticta* and mistaken identity, mistake problems have no preponderant sales law dimension. We therefore recommend that the proposals be deferred for further study as part of the Law of Contract Amendment Project.

6. FORMALITIES OF FORMATION (STATUTE OF FRAUDS REQUIREMENTS)¹³⁹

(a) INTRODUCTION

One of the most familiar landmarks in *The Sale of Goods Act* is the Statute of Frauds provision in section 5. This section reads as follows:

5.—(1) A contract for the sale of goods of the value of \$40 or more is not enforceable by action unless the buyer accepts part of the goods so sold and actually receives them, or gives something in earnest to bind the contract or in part payment, or unless some note or memorandum in writing of the contract is made and signed by the party to be charged or his agent in that behalf.

(2) This section applies to every such contract notwithstanding that the goods may be intended to be delivered at some future time, or may not at the time of the contract be actually made, procured, or provided, or fit or ready for delivery, or some act may be requisite for the making or completing thereof, or rendering them fit for delivery.

(3) There is an acceptance of goods within the meaning of this section when the buyer does any act in relation to the goods that recognizes a pre-existing contract of sale, whether there is an acceptance in performance of the contract or not.

As is well-known, section 5 has an ancient lineage and reproduces, with minor modifications, section 17 of the *Statute of Frauds, 1677*.¹⁴⁰ The passage of time has not, however, improved its image. The Commission has reached the conclusion that section 5 has outlived whatever usefulness it may have had, and that it should be omitted in its entirety from the revised Act. In taking this step, Ontario would be following the respectable precedents set by the U.K. *Law Reform (Enforcement of Contracts) Act 1954*,¹⁴¹ its New Zealand counterpart,¹⁴² and the amendment adopted by

¹³⁸See, Rabin, "A Proposed Black-Letter Rule Concerning Mistaken Assumptions in Bargain Transactions" (1967), 45 Tex. L. Rev. 1273.

¹³⁹See, also, Crawford, "Formalities of Formation (Statute of Frauds)", Research Paper No. II.4.

¹⁴⁰29 Car. 2, c. 3 (part), as amended by 9 Geo. 4, c. 14, s. 7.

¹⁴¹2 & 3 Eliz. 2, c. 34, s. 2.

¹⁴²*Contracts Enforcement Act*, 1956, s. 4.

British Columbia in 1958.¹⁴³ These in turn merely implement the recommendations of several committees of inquiry in various parts of the Commonwealth.¹⁴⁴ We note, too, that neither the Hague Uniform Laws nor the UNCITRAL draft Convention contains a Statute of Frauds requirement.

The recommendations to which we have referred climax the criticisms of a generation of scholars. In one of the earliest critiques of section 17 of the Statute of Frauds,¹⁴⁵ Mr. Justice Stephen and Sir Frederick Pollock concluded as follows:

. . . in the vast majority of cases its operation is simply to enable a man to break a promise with impunity, because he did not write it down with sufficient formality.

The Report of the English Law Reform Committee of 1953, which led to the adoption of the 1954 Act, echoed the same sentiments and made the following observations concerning the Statute of Frauds provisions:¹⁴⁶

[They have] . . . outlived the conditions which generated and, in some degree, justified them; . . . they operate in an illogical and often one-sided and haphazard fashion . . . and . . . on the whole . . . promote rather than restrain dishonesty.

In our opinion these criticisms are just as applicable to Ontario as they are to the United Kingdom.

(b) SOME EMPIRICAL DATA

The arguments in favour of the repeal of section 5 are already so fully documented that no good purpose would be served by repeating them here. It may, however, be useful to refer to one of the most commonly made points: that the section fails to reflect business practices and that it is futile to force contracting parties to adopt procedures that do not correspond to their legitimate needs and expectations. The gulf between law and practice is brought out clearly in the results of the C.M.A. Questionnaire.¹⁴⁷ In the Questionnaire a substantial group of questions was designed to elicit information with respect to the frequency and importance of writings. In their capacity as purchasers of supplies, 91.3% of the respondents claimed that they themselves customarily provide evidence of the contract. On the other hand, only 25.6% of the respondents reported that they "always" receive an unsolicited confirmation from their suppliers. In the result,¹⁴⁸ although probably bound themselves, approxi-

¹⁴³S.B.C. 1958, c. 52, s. 17.

¹⁴⁴Law Reform Committee, *First Report (Statute of Frauds and Section 4 of the Sale of Goods Act, 1893)* (1953), (Cmd. 8809). See also Law Reform Commission, New South Wales, *Working Paper on The Sale of Goods* (1975), Part 4.

¹⁴⁵Stephen and Pollock, "Section Seventeen of the Statute of Frauds" (1885), 1 L.Q. Rev. 1, 4.

¹⁴⁶Law Reform Committee, footnote 144 *supra*, para. 2.

¹⁴⁷See, Crawford, footnote 139 *supra*, pp. 20 *et seq.*

¹⁴⁸*Ibid.*, p. 21.

mately 60% of the respondents estimate that they would only sometimes, or rarely, or never, be in a position to enforce the contract by a writing delivered by the other party.

The relative unimportance attached by manufacturers to receiving written confirmation of orders, or written confirmation of oral variations of earlier orders, is illustrated in other respects. A "staggering" 79.9% admit that even where they have not received a writing they will begin production or even shipment without a writing.¹⁴⁹ Our research also indicates that fully 84.1% of the respondents admitted that they would "always" (22.3%), "usually" (35.6%) or at least "sometimes" (26.2%) start production or shipment on an oral agreement to vary the terms of the written order.¹⁵⁰ There was little evidence that the respondents were sensitive to (or perhaps able to react sensitively to) the \$40 exception contained in section 5; or, for that matter, that they might be sensitive to any higher contract values that might be substituted. It may, therefore, be concluded that manufacturers do not modify their patterns of reliance upon oral contracts according to whether or not they are legally enforceable.

Businessmen's different perceptions are also reflected in their reaction to cancelled contracts.¹⁵¹ Of the respondents, 70.1% replied that they would "never" sue if a purchaser cancelled an order, whether written or oral, even after they had begun production. On the other hand, and perhaps anomalously, the respondents still appear to attach considerable importance to the existence of writing as a condition of the enforcement of contracts. The great majority (95.2%) thought that, where both parties had signed documents relating to an order, the transaction ought to be legally enforceable; 68.2% thought it was sufficient that the defendant had signed an order, and 60.8% were prepared to extend that protection even to an oral order "where the suing party has performed". Only 13.9% apparently supported enforcement where "neither party has signed documents relating to an order and the suing party has not performed".

The disparity between what the respondents actually do and the norms they claim to support is striking, and not easily explained. In part it seems to reflect many a layman's view about the sanctity of a written commitment and the fragility of the verbal promise. A more important reason probably lies in the fact that most businessmen are so little dependent on legal norms for the successful operation of their daily transactions that they are willing to subscribe to a Statute of Frauds requirement without apparently appreciating the serious inequities it is capable of causing. Given these considerations, it would surely be unwise to use this particular set of answers as a reliable guide to the future disposition of section 5.

¹⁴⁹*Ibid.*, p. 22.

¹⁵⁰*Ibid.*, p. 24.

¹⁵¹*Ibid.*, pp. 24-25. In the present paragraph we have adjusted some of the percentages that are cited in Mr. Crawford's paper from absolute to relative or adjusted frequencies.

(c) ABOLITION VERSUS MODIFICATION: UCC 2-201

Section 5 of the *Uniform Sales Act* reproduced section 17 of the *Statute of Frauds*, 1677 with two important modifications:¹⁵² namely, by raising the monetary figure of bargains excepted from the reach of the section to \$500, and by excluding altogether goods manufactured specially to the buyer's order. Section 2-201 of the *Uniform Commercial Code* attempts to meet the traditional criticisms of the section still further by incorporating two additional important changes. First, the need for a memorandum in writing incorporating all the terms of the bargain is abolished, and the plaintiff need now only show "some writing sufficient to indicate that a contract for sale has been made".¹⁵³ Secondly, between merchants the writing requirement is satisfied if, within a reasonable time, a writing in confirmation of the contract and sufficient against the sender is received, and if the recipient has reason to know its contents and gives no written notice of objection within ten days of receipt.¹⁵⁴

If there were some intrinsic merit to retaining a Statute of Frauds requirement, these modifications would have much to commend them. But, in our view, there is no such merit; certainly, we know of no arguments in favour of retention that can match those in favour of abolition. No adverse consequences have been noticed during the twenty-five years that have elapsed since the repeal of the section in the United Kingdom and other jurisdictions;¹⁵⁵ and there does not appear to be any foundation for the fear that parties may be tempted to produce perjured evidence. We note, too, the dearth of post-World War II sales litigation involving section 5, which suggests that lawyers have lost the enthusiasm that they once entertained for this section as a defensive shield. We believe that the courts would be quite capable of dealing with the exceptional case of fraud, if it arose, and that the advantages to the legal system of repealing the section will greatly exceed any resultant disadvantages. Accordingly, the Commission recommends that the revised Act should contain no provision equivalent to section 5. It should, however, be clearly understood that our recommendation is confined to contracts for the sale of goods, and that we express no opinion with respect to the desirability of retaining Statute of Frauds requirements in the case of other types of contract.

7. THE PAROL EVIDENCE RULE¹⁵⁶

(a) THE PROBLEM

A question considerably more difficult to answer than whether section 5 should be abolished is what changes, if any, should be made to the

¹⁵²*Ibid.*, pp. 8-10.

¹⁵³UCC 2-201(1).

¹⁵⁴UCC 2-201(2).

¹⁵⁵See, Crawford, footnote 139 *supra*, p. 15.

¹⁵⁶In considering our position on this topic, we have benefited from, *inter alia*, a memorandum on the parol evidence rule prepared by Mr. (now Professor) Robert Forbes under the guidance of Mr. Bradley Crawford. We are grateful to these gentlemen for their assistance, but wish to make it clear that neither of them is responsible for the views that follow.

parol evidence rule. As generally stated,¹⁵⁷ the rule provides that, where the parties have intended a writing to be the final expression of their agreement, extrinsic evidence is not admissible to add to, vary or contradict the written terms of the agreement.

The purpose of the rule, it is said,¹⁵⁸ is to foster certainty and predictability in legal transactions, to reduce the danger of perjured evidence and fallible memories, and to discourage protracted trials on evidentiary issues. These are certainly commendable goals, and if they could be accomplished simply and efficiently in practice without causing greater harm than the rule was designed to avoid, there would be little justification for tampering with the rule. In fact, there is a marked divergence between practice and theory,¹⁵⁹ and the defects in the rule have been the subject of mounting criticism.¹⁶⁰ In a recent Working Paper¹⁶¹ the English Law Commission deemed the defects to be sufficiently serious to warrant abolition of the rule. The question that we have considered is whether this recommendation should be followed in the revised Sale of Goods Act.

The following are some of the major objections to the rule:

(i) *The rule is seriously ambiguous.* The rule purports to state that, if the parties have intended a writing to be the final expression of their agreement, extrinsic evidence will not be admitted to alter its terms. Logically, therefore, in every case the court should embark upon an investigation of all the surrounding circumstances to determine the parties' intention, a process that would necessarily involve the admissibility of extrinsic evidence. Corbin¹⁶² has adopted this position, and so have an increasing number of American courts.¹⁶³ The parol evidence rule in Article 2, section 2-202, appears to favour the same approach.¹⁶⁴ The

¹⁵⁷For a general discussion of the rule and the exceptions to it, see: Sopinka & Lederman, *The Law of Evidence in Civil Cases* (1974), pp. 269 *et seq.*; Treitel, *The Law of Contract* (4th ed., 1975), pp. 121 *et seq.*; Fridman, *The Law of Contract in Canada* (1976), pp. 245 *et seq.*; Waddams, *The Law of Contracts* (1977), pp. 191 *et seq.*; Cross, *Evidence* (3rd ed., 1967), pp. 508 *et seq.*

¹⁵⁸Compare, *Ellis v. Abell* (1884), 10 O.A.R. 226, especially *per* Burton, J.A., at pp. 246 *et seq.*

¹⁵⁹Writing in 1963, Corbin commented that "the most active field of contract litigation at present is that of interpretation and the 'Parol Evidence Rule'. Probably one-half of the reported cases are concerned primarily therewith": *Corbin on Contracts* (1963), Vol. 1, p. iv.

¹⁶⁰See, for example, Sweet, "Contract Making and Parol Evidence: Diagnosis and Treatment of a Sick Rule" (1968), 53 Corn. L. Rev. 1036; Comment, "The Parol Evidence Rule: Is it Necessary?" (1969), 44 N.Y.U.L. Rev. 972; Law Commission, Working Paper No. 70, *Law of Contract, The Parol Evidence Rule* (1976); Law Reform Commission, New South Wales, *Working Paper on The Sale of Goods* (1975), Part 5.

¹⁶¹Law Com. W.P. No. 70, footnote 160 *supra*.

¹⁶²*Corbin on Contracts*, Vol. 3, s. 573, at p. 360. See, also, *Restatement of the Law of Contracts*, s. 228, and *Restatement of the Law, Contracts 2d, Tent. Draft*, s. 235.

¹⁶³See, for example, *Masterson v. Sine* (1968), 436 P. 2d 561 (Cal. Sup. Ct.); *Royal Industries v. St. Regis Paper Co.* (1969), 420 F. 2d 449 (9th Cir.).

¹⁶⁴See, UCC 2-202, Comment 3; White & Summers, footnote 17 *supra*, pp. 68-70. The Code provisions are discussed hereafter.

traditional attitude of the Anglo-Canadian courts, on the other hand,¹⁶⁵ has been to say that if a writing "looks" like an integrated expression of the parties' agreement (sometimes referred to as the "appearance test"), and *a fortiori* if the writing contains an integration clause,¹⁶⁶ it will be treated so in fact. It is this feature of the rule that lies at the root of so many of the difficulties.¹⁶⁷

(ii) *The rule is more honoured in the breach than in its observance.* Over the years many exceptions¹⁶⁸ have developed to the rule. It is not difficult for a sympathetic judge to fasten on one or other of these exceptions for the purpose of relaxing the strict application of the rule. Some of the exceptions are very difficult to reconcile with the rule. Of particular importance is the admissibility of extrinsic evidence to prove a collateral contract.¹⁶⁹ It was at one time thought that such evidence was only admissible to supplement the terms of the writing, but recent English and Canadian cases¹⁷⁰ show that the exception is not so confined. These and other post-war decisions indicate a growing dissatisfaction with the rule, and reject it in all but name where it is seen to work hardship.

(iii) *The rule does not recognize the realities of modern standard form agreements.*¹⁷¹ The rule had its origins in an era when writing was a much more deliberative act than it is at present, and when the rules of evidence generally were much stricter. Today, the typical sales contract, when it is signed by both parties, is of a standard form. With the exception of the core terms, such as price, quantity and description, it is more likely to be an expression of the seller's need for uniformity than the result of genuine bargaining between buyer and seller. This truism has been increasingly recognized by both courts and legislatures through the development of the doctrine of unconscionability and of other means to curb one-sided terms. The logical corollary of this trend should have been an equally cautious approach to the parol evidence rule: it is no more realistic to assume that the buyer intended the writing to be the final and exclusive expression of the parties' agreement than it is to assume that he freely agreed to all the printed terms. This was the rationale underlying our recommendation in the Report on Consumer Warranties

¹⁶⁵See, Wedderburn, "Collateral Contracts", [1959] Camb. L.J. 58, 60-61, cited in Law Com. W.P. No. 70, footnote 160 *supra*, para. 29.

¹⁶⁶That is, a clause stating that the writing contains the whole agreement between the parties.

¹⁶⁷Compare, Law Com. W.P. No. 70, footnote 160 *supra*, paras. 26 *et seq.*

¹⁶⁸The number of exceptions varies among writers. The Law Commission's Working Paper, footnote 160 *supra*, paras. 10 *et seq.*, lists eight: namely, vitiating factors; condition precedent; rectification; specific performance and rescission; damages for misrepresentation; non-exclusiveness of writing; collateral contract; and, custom and implied terms.

¹⁶⁹See, Law Com. W.P. No. 70, footnote 160 *supra*, pp. 10-12; Wedderburn, footnote 165 *supra*.

¹⁷⁰*City of Westminster Properties (1934) Ltd. v. Mudd*, [1959] Ch. 129; *Mendelsohn v. Normand*, [1970] 1 Q.B. 177; *Evans & Son Ltd. v. Andrea Merzario Ltd.*, [1976] 2 All E.R. 930 (C.A.); *Canadian Acceptance Corp. v. Mid-Town Motors Ltd.* (1970), 72 W.W.R. 365 (Sask. Dist. Ct.). Compare, *Hawrish v. Bank of Montreal*, [1969] S.C.R. 515.

¹⁷¹Compare, Law Reform Commission, New South Wales, footnote 160 *supra*, para. 5.9.

and Guarantees¹⁷² that the rule should be abolished in consumer sales. Presumably, it also provided the motivation for the abolition of the rule in *The Business Practices Act*.¹⁷³ We are not persuaded that, in this context, the distinction between consumer and non-consumer transactions is meaningful. It is not so obvious to us that a small businessman, artisan, or even professional person, signing a contract of adhesion¹⁷⁴ should always be deemed to have a better understanding of the rules of evidence and contract than a consumer; indeed, the empirical evidence is very much to the contrary.

(iv) *The rule draws an artificial distinction between contractual and non-contractual representations.* In the absence of an integration clause, the rule does not apply to a non-contractual representation inducing the formation of the contract. By definition, such a representation is not a term of the contract, and admitting it in evidence will not vary or contradict the contract. A later recommendation in this Report¹⁷⁵ favours the adoption of a reliance test to determine whether or not a representation amounts to a warranty: that is, whether or not it is to be treated as a term of the contract. The acceptance of this recommendation could lead to representations being treated more readily as terms of the contract than they are at present. The retention of the parol evidence rule in its existing form could substantially undermine this desirable goal, since it would frequently preclude the representee from giving evidence of the representation, where the representation is not reproduced in the written form of the agreement.

(v) *The rule runs against the modern trend in the law of evidence.*¹⁷⁶ The current trend is to relax the rules of evidence and to admit relevant and probative evidence, leaving its cogency and credibility to the trier of fact. Jury trials in Canada in commercial cases are very unusual. We are not, therefore, confronted with the dilemma of the ability of juries to weigh accurately the credibility of parol evidence. This dilemma appears to be an important reason for the continued support for the retention of the parol evidence rule in the United States, where juries are much more common.

(vi) *The rule does not, in fact, lead to more efficient or speedier trials.* Even the most ardent advocates of the rule would not deny the need for exceptions to the rule; nor would they deny the need for some sort of test to determine whether or not the writing is an integrated expression of the parties' agreement. These issues cannot, however, be decided without admitting at least *some* extrinsic evidence, even though, ultimately, the evidence or its effect may be rejected because it conflicts with the rule. The saving, therefore, in judicial time is at best only marginal, even assuming — which we do not — that efficiency considera-

¹⁷²Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), p. 30.

¹⁷³S.O. 1974, c. 131, s. 4(7).

¹⁷⁴A contract of adhesion is a standard form contract whose pre-printed terms are non-negotiable.

¹⁷⁵See, *infra*, ch. 6, pp. 139, 142.

¹⁷⁶Compare, Law Com. W.P. No. 70, footnote 160 *supra*, paras. 35-36.

tions of this nature should play a critical role in determining the future of the rule.

Considerations such as the above led the English Law Commission to conclude¹⁷⁷ that the "Parol evidence rule no longer serves any useful purpose. It is a technical rule of uncertain ambit which, at best, adds to the complications of litigation without affecting the outcome and, at worst, prevents the courts from getting at the truth." We agree with this verdict, and now proceed to consider a number of possible solutions to the present impasse.

(b) ALTERNATIVE SOLUTIONS

We have already indicated the English Law Commission's proposal to abolish the parol evidence rule. The New South Wales Law Reform Commission in its *Working Paper on the Sale of Goods* has made a recommendation which, although it appears to be similar in effect, is expressed differently. The Commission proposed that the rule be modified "so that if a contract for the sale of goods is in writing the presumption is that it is not intended to be the conclusive and exclusive record of the transaction and that the onus of proof that it is so intended should be on the party alleging such to be the case".¹⁷⁸ The Commission also felt that the use of standard clauses to establish such an intention should be frowned upon, and that they should be given little or no weight.¹⁷⁹ We construe these recommendations as involving the abolition of the existing rule, coupled with a shifting of the burden of proof to the party alleging the integrated nature of the writing. It is not, however, clear from the Working Paper how the burden is to be discharged in practice, or what would be sufficient to discharge the burden.

Another alternative would be to confer upon the court the power not to apply the rule in a given case where, in the court's opinion, it would be unreasonable to do so. Although initially attracted to this solution as a compromise between total abolition and maintenance of the status quo, we are of the view that it suffers from two important weaknesses. The first is that it does not address itself directly to the artificial nature of the rule: it seeks to mitigate, rather than eliminate, the rule. The second is that it would add one more element of uncertainty in an area already abounding in uncertainty. The Commission therefore rejects this approach.

Another possible compromise is found in UCC 2-202. This section reads as follows:¹⁸⁰

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by

¹⁷⁷*Ibid.*, para. 43.

¹⁷⁸Law Reform Commission, New South Wales, *Working Paper on The Sale of Goods* (1975), p. 60.

¹⁷⁹*Ibid.*

¹⁸⁰Compare, *Restatement of the Law, Contracts 2d, Tent. Draft*, ss. 239-242.

evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

- (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and
- (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

This section goes a substantial distance towards removing the objections to the parol evidence rule; but, in our opinion, it does not go far enough. The strengths of the section are as follows: (a) it rejects any assumption that, because some of the terms of an agreement have been reduced to writing, the parties intended it to be the final expression of all the terms; and, (b) its inferential rejection of the "four corners" or "appearance" test in determining the finality and exclusiveness of a writing. The weaknesses of the section are two-fold. First, it disallows the admissibility of extrinsic evidence that contradicts an express written term, whether or not the writing was intended to be an integrated document. Secondly, it fails to indicate how much weight is to be given to an integration or merger clause. As might be expected, the first weakness has proved to be particularly troublesome in practice, and some courts¹⁸¹ have been forced to resort to some rather artificial reasoning to justify the admissibility of extrinsic evidence that conflicts with the parties' writing.

(c) CONCLUSION

Having reviewed the various alternatives, a majority of the Commission is impressed by the simplicity and flexibility of the English Law Commission's proposal, and adopts it as its own. Accordingly, we recommend¹⁸² that the parol evidence rule should not apply to a contract for the sale of goods. In the view of the majority of the Commissioners, the principal weakness of the parol evidence rule, as traditionally applied in England and Canada, has been the near-conclusive presumption of exclusiveness attached to formal instruments. If this hurdle is removed (and this, in our opinion, is all that the abolition of the parol evidence

¹⁸¹See, for example, *Hunt Foods Industries, Inc. v. Doliner* (1966), 270 N.Y.S. 2d 937; *Division of Triple T. Serv. Inc. v. Mobil Oil Corp.* (1969), 304 N.Y.S. 2d 191; Duesenberg and King, footnote 23 *supra*, p. 4-138.

¹⁸²One of the Commissioners, the Honourable J. C. McRuer, dissents from this recommendation. In Mr. McRuer's view, the abolition of the parol evidence rule as expressed in section 4.6 of the Draft Bill would put the law of evidence, as it relates to the sale of goods, in great confusion. The jurisprudence that has been developed over many years with respect to the evidentiary value of written agreements would be destroyed. This would provoke endless litigation. "The parol evidence rule does not apply to contracts for the sale of goods" is a colloquial expression to convey an idea. It is not suitable in any case for statutory form. Section 4.6 should be deleted from the Bill. Provision may be made in the statute to the effect that a term in a written contract for the sale of goods, that provides that "the writing represents the exclusive expression of the parties' agreement" may be held inoperative where the Court holds that to enforce the written contract would be oppressive to a party to the contract, having regard to all the circumstances.

rule implies) it merely clouds the issue to encumber the reform with the type of qualifying language used in the Code. The majority finds support for this conclusion in the apparent success with which the provisions abolishing the rule have been applied in *The Business Practices Act* and in comparable statutes elsewhere.

It needs to be emphasized, however, as the English Law Commission also emphasized,¹⁸³ that the abolition of the parol evidence rule is not likely to effect a radical change. The courts will continue to attach very great weight, and rightly so, to written terms freely consented to by the parties; they will continue to express scepticism with respect to the consensual nature of unbargained terms contained in printed forms of agreement. The main difference is likely to be that there will be less frequent recourse to circumstances that now constitute exceptions to the rule, especially the exception based on collateral agreements. This result would follow because, in the light of the evidence, the court would find it easier than under existing law to hold that the writing could not have been intended as the final and exclusive expression of the parties' agreement.

(d) CONSEQUENTIAL ISSUES

We deal with two such issues. The first involves the conclusive character of merger or integration clauses. In our opinion, it would be futile to abolish the parol evidence rule without also indicating the status of such clauses. Canadian courts have generally tended to take them at face value.¹⁸⁴ American courts have been divided in their approach, but those courts that have rejected the "four corners" rule have also rejected the conclusive character of merger clauses.¹⁸⁵ This seems to us to be correct in principle. We therefore recommend that a provision in a writing, purporting to state that the writing represents the exclusive expression of the parties' agreement, should have no conclusive effect. Our Draft Bill contains a provision to this effect.¹⁸⁶ An alternative approach would have been to let the general unconscionability provision in the revised Act police the reasonableness of such clauses. In view of the importance and ubiquitousness of merger clauses, however, we think it better to provide some specific guidance than to leave the question completely at large.

The second issue is whether the abolition of the rule should be accompanied by special provisions with respect to the position of third parties claiming rights under the writing. We have decided that this is not necessary for a number of reasons. First, the rule in equity is¹⁸⁷ that the

¹⁸³Law Com. W.P. No. 70, footnote 160 *supra*, paras. 41-42.

¹⁸⁴See, for example, *Spelchan v. Long* (1956), 2 D.L.R. (2d) 707 (B.C.C.A.); *Dodds v. Millman* (1964), 47 W.W.R. 690, 45 D.L.R. (2d) 472 (B.C.S.C.); *Advance Rumely Thresher Co. v. Keene*, [1919] 2 W.W.R. 143, 47 D.L.R. 251 (Sask. C.A.); and compare, *Royal Bank of Canada v. Hale* (1962), 30 D.L.R. (2d) 138 (B.C.S.C.).

¹⁸⁵In addition to the authorities cited in footnote 163 *supra*, see *Kupka v. Morey* (1975), 17 U.C.C. Rep. 1383, especially at p. 1392 (Alaska Sup. Ct.), and *Luther Williams Jr., Inc. v. Johnson* (1967), 229 A. 2d 163 (D.C.C.A.). Compare, White & Summers, footnote 17 *supra*, p. 80.

¹⁸⁶See, Draft Bill, s. 4.6.

¹⁸⁷See, Treitel, footnote 157 *supra*, p. 468.

assignee of a chose in action (which includes, of course, an assignee of contract rights) takes subject to equities; hence, an assignee is already very vulnerable under existing law, and the abolition of the parol evidence rule will not change his position materially. For example, in an action by an assignee of the seller's right to payment, the buyer is free to allege that the goods were never delivered, were not satisfactory, or that the agreement was induced by misrepresentation. Another reason is that, in the comparable provision in section 4(7) of *The Business Practices Act* abolishing the parol evidence rule in consumer transactions, no exception is made in favour of third parties.¹⁸⁸ Further, the proposed provision only addresses itself to contracts of sale and does not purport to affect other transactions such as negotiable instruments, documents of title, or real estate conveyances where the rights of third parties do not depend upon equitable rules of assignment. A fourth reason is that, in sales situations, the problem is most likely to arise when an executed agreement has been discounted with a financial intermediary as, for example, in the case of consumer credit agreements and "factored" accounts. In such cases it is customary, or open, to the assignee to protect himself by various devices such as obtaining an acknowledgment of the account from the buyer, insertion of a "cut-off" clause in favour of the assignee, and the execution of a promissory note. The abolition of the parol evidence rule should not interfere with these practices.¹⁸⁹ Finally, in our view, if it is desired to attach negotiable incidents to particular types of writing, it should be done by other means.

Accordingly, the Commission does not recommend that the abolition of the parol evidence rule should be accompanied by special provisions with respect to the position of third parties claiming rights under the writing.

8. COURSE OF PERFORMANCE AND CONSTRUCTION OF AGREEMENT

Anglo-Canadian and American law has long recognized the admissibility of trade usages and course of dealing between the parties in construing the terms of their agreement and filling gaps. We deal with these gap filling functions in chapter 8. Our present concern is with the admissibility of evidence that shows the manner in which the parties applied the agreement in practice as an aid in construing its terms. The English rule,¹⁹⁰ as reaffirmed by the House of Lords in *Schuler A.G. v. Wickman Machine Tool Sales Ltd.*,¹⁹¹ is that such evidence is not admissible.

¹⁸⁸Note, however, the restrictions in s. 4(1)(b) on the right to rescission of the agreement where a third party has acquired a right in the subject matter of the agreement. We do not pause to examine the implications of this restriction in consumer transactions, or how the provision is to be reconciled with s. 42a of *The Consumer Protection Act*, R.S.O. 1970, c. 82 as am.

¹⁸⁹Such practices are, however, affected by statutory restrictions such as s. 42a of *The Consumer Protection Act*, *supra*, and Part V of the *Bills of Exchange Act*, R.S.C. 1970 (1st Supp.), c. 4, and the "joint venture" doctrine enunciated in *Federal Discount Corp. Ltd. v. St. Pierre*, [1962] O.R. 310 (C.A.).

¹⁹⁰See, Fridman, *The Law of Contract in Canada* (1976), pp. 249-51.

¹⁹¹[1974] A.C. 235 (H.L.).

sible for this purpose; the Canadian jurisprudence is more liberal,¹⁹² but could be affected by the reverse English trend. Under the Code such evidence is clearly admissible. Section 2-208 provides:

(1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (Section 1-205).

(3) Subject to the provisions of the next section on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

We believe the Code rule is much to be preferred and we recommend its adoption in the revised Act.¹⁹³ The reason given by Lord Reid in an earlier case¹⁹⁴ for rejecting evidence of course of performance was that, if such evidence were admissible, a contract might mean one thing the day it was signed, and something different a month or a year later. We agree with a learned commentator¹⁹⁵ that this fear is exaggerated and we believe that, in practice, the courts should have no difficulty in distinguishing between reliable and unreliable forms of post-formational evidence.¹⁹⁶ It will be noted that UCC 2-208(1) provides careful guidance as to what constitutes reliable evidence. In our view, the section provides adequate safeguards against the possibility that a contract breaker will seek to use his breaches as evidence of the meaning of the agreement or as evidence of a waiver or modification of it.

It will also be observed that, under the Code, evidence of course of performance is not restricted to cases of ambiguous contractual language, as appears to be true in Canada. Comment 1 to UCC 2-208 justifies this liberalized approach on the ground that "The parties themselves know

¹⁹²See, for example, *Bank of Montreal v. Univ. of Saskatchewan* (1953), 9 W.W.R. 193 (Sask. S.C.); *Man. Dev. Corp. v. Columbia Forest Products Ltd.* (1973), 43 D.L.R. (3d) 107 (Man. C.A.); *Re Canadian National Railway Co. and Canadian Pacific Ltd.* (1978), 83 D.L.R. (3d) 86 (B.C.S.C.).

¹⁹³See, Draft Bill, s. 4.7.

¹⁹⁴*James Miller & Partners Ltd. v. Whitworth Street Estates (Manchester) Ltd.*, [1970] A.C. 583 (H.L.), 603.

¹⁹⁵Fridman, footnote 190 *supra*, p. 251.

¹⁹⁶Compare, Lord Denning, M.R., in *Port Soudan Cotton Co. v. Chettiar and Sons*, [1977] 2 Lloyd's Rep. 5 (C.A.), at 11:

I am sorry about this [rule laid down in *James Miller & Partners*, footnote 194 *supra*] because it is I believe contrary to the rule in every other civilised system of law, including the other countries of the Common Market.

best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was". The same rationale is used by the draftsmen in UCC 2-202 in admitting evidence of course of performance, as well as usage and course of dealing, to explain or supplement a written agreement. In neither case, however, is the admissibility unqualified; by virtue of UCC 2-208(2) the extrinsic evidence must be consistent with the express terms. If it is not, it cannot be received as evidence of the meaning of the express terms of the agreement, although, by UCC 2-208(3), it may be evidence of a waiver or modification of the inconsistent term. In practice, it may not always be easy to apply the distinction, but this difficulty is unavoidable. Subject to this caveat, we support also these features of UCC 2-208.

9. ASSIGNMENT OF RIGHTS AND DELEGATION OF PERFORMANCE¹⁹⁷

It is very common for a seller to assign his right to payment under a contract of sale. An assignment of this nature may be either a specific assignment, as under a factoring agreement, or by way of a general assignment of book debts to a bank or other financial intermediary to serve as security for a loan. In an important group of contracts, it is also common for a seller to delegate performance of some of his contractual duties; for example, the manufacture of components in a contract to supply a larger unit. It is less common for a buyer to assign his benefits under a contract of purchase. This situation may, however, arise should the buyer want to sell his business as a going concern or, in the case of a corporation, if there is a programme of corporate reorganization; or, again, the buyer may find it profitable to sell the contract without tying the assignment to a larger transaction.

The Sale of Goods Act does not address itself to this group of questions, but leaves them to be decided by the general law of assignments. In Ontario this implies a reference to the common law principles of assignment, to section 54 of *The Conveyancing and Law of Property Act*,¹⁹⁸ and to *The Personal Property Security Act*.¹⁹⁹ Unfortunately, these sources are not fully integrated and are deficient in several respects: that is, they contain some important anomalies and fail to provide clear answers to some major questions. It is desirable, therefore, to discuss these problems briefly, to indicate how the corresponding questions have been answered in the *Uniform Commercial Code*, and to recommend desirable changes in Ontario law. As will be seen, the recommendations affect different facets of the law of assignments, and some bear more heavily on sales law than others. We are, therefore, of the view that, while an important group of changes can be incorporated in the revised Act, others belong more appropriately to *The Personal Property Security Act* or should be incorporated in a Law of Contract Amendment Act.

Accordingly, we now turn our attention to the following topics: (a) the formalities governing the assignment of rights; (b) the scope of *The*

¹⁹⁷See, also, Christopher Carr, "Assignment of Choses in Action and Delegation of Performance", Research Paper No. III.8a.

¹⁹⁸R.S.O. 1970, c. 85.

¹⁹⁹R.S.O. 1970, c. 344 as am.

Personal Property Security Act in relation to assignments; (c) the status of 'no assignment' clauses; and, (d) the right of the original contracting parties to modify the terms of their contract after notice of an assignment has been given. To round off our survey, brief mention will also be made of several other provisions in UCC 2-210, which should be considered for inclusion in the revised Sale of Goods Act.

(a) THE FORMALITIES OF ASSIGNMENT

Existing Ontario law recognizes three forms of assignment of choses that are germane to contracts of sale. These are assignments in equity,²⁰⁰ the statutory form of assignment under section 54 of *The Conveyancing and Law of Property Act*,²⁰¹ and the provisions in *The Personal Property Security Act*.²⁰² The relevant provisions in *The Personal Property Security Act*²⁰³ generally apply to all types of security interest in personal property, tangible or intangible, and also apply to an absolute assignment of book debts.²⁰⁴ These provisions appear, however, to conflict in important respects with section 54 of *The Conveyancing and Law of Property Act*.²⁰⁵ This is a matter that warrants further inquiry. The differences between the equitable form of assignment and the formalities necessary to comply with section 54 of *The Conveyancing and Law of Property Act* are also striking. An equitable assignee need not be in writing; it may comprise all or part of the chose and may be by way of charge or absolute; further, no notice is necessary to the obligor in order to perfect the assignment. Section 54 states converse rules on all these points.

The differences would be understandable if they led to significant differences in result. But, as has been shown elsewhere,²⁰⁶ the only apparent difference is procedural: an equitable assignee must as a general rule join the assignor in any action brought against the obligor whereas a statutory assignee can sue in his own name. Even this procedural distinction may have disappeared in view of the provisions of Rule 89 of the Ontario Rules of Practice.²⁰⁷

If this conclusion is correct, section 54 is a formidable provision

²⁰⁰Compare, *Di Guilo v. Boland*, [1958] O.R. 384, 13 D.L.R. (2d) 510 (C.A.).

²⁰¹Supra, footnote 198.

²⁰²Supra, footnote 199, especially ss. 2 and 1(y).

²⁰³That is, those involving the creation, perfection, priority and enforcement of the security interest.

²⁰⁴See, s. 2(b).

²⁰⁵Note, in particular, that under *The Personal Property Security Act*, registration of a financing statement, not notice to the account debtor, is necessary to perfect an absolute or security interest in an intangible, and the assignment can be by way of charge or otherwise. Moreover, between assignor and assignee, even an oral assignment may be effective: see, *The Personal Property Security Act*, R.S.O. 1970, c. 344 as am., ss. 9, and 68; but see s. 11, which requires the secured party to deliver "a copy of the security agreement to the debtor within ten days after the execution thereof". Section 69 of the Act provides that, in the event of conflict between the statute and any other general or special Act, other than *The Consumer Protection Act*, *The Personal Property Security Act* is to prevail.

²⁰⁶See, Carr, footnote 197 *supra*, pp. 7-8.

²⁰⁷Rule 89 provides: "An assignee of a chose in action may sue in respect thereof without making the assignor a party."

which accomplishes very little. It seems to us that, if joinder of the assignor is desirable in certain types of assignments, it can be, and indeed already is, more efficiently handled by rules of court. The requirement ought not to turn on the accident of the form of assignment. The same observation could be made with respect to the need for written assignments. We therefore recommend a general review of the formalities governing assignments of choses in Ontario, with a view to their rationalization and modernization.

(b) THE SCOPE OF THE PERSONAL PROPERTY SECURITY ACT

The Personal Property Security Act applies to security interests in all forms of intangibles and, unlike *The Assignments of Book Debts Act*,²⁰⁸ which it replaces, applies to the specific assignment of a book debt as well as to a general assignment of book debts.²⁰⁹ It also applies to an absolute assignment of book debts,²¹⁰ and this could have some undesirable consequences. Assume that a supplier assigns the right to payment under a requirements contract and also delegates his obligations under the contract. It is unlikely that the assignee would realize that *The Personal Property Security Act* governs the transaction, and that he must perfect the assignment in accordance with its provisions. Section 9-104(f) of the *Uniform Commercial Code* excludes this type of assignment, as well as a number of other types of assignment not deemed to be of commercial importance, from the scope of Article 9, which deals with secured transactions. We recommend that consideration should be given to the insertion of a similar provision in *The Personal Property Security Act*.

(c) THE STATUS OF 'NO ASSIGNMENT' CLAUSES

It is quite common for agreements with public authorities, government departments, and other large scale buyers and suppliers to contain clauses prohibiting the assignment 'of the contract' without the other party's consent. The reasons for the presence of such clauses is explained by Gilmore in the following passage:²¹¹

Prohibitions of assignment have their principal commercial use in the case of obligors who have large numbers of creditors to deal with. There are public authorities, federal, state and municipal, dealing with contractors. There are prime or first-tier contractors dealing with sub-contractors. There are manufacturers dealing with suppliers of raw materials, component parts or sub-assemblies. There are banks dealing with holders of bank obligations. There are insurance companies dealing with policy holders. It is easy to understand why obligors so situated are loath to be required to recognize claimants other than those they originally dealt with. Where thousands and tens of thousands of claims are involved, the mere book-keeping, if transfers must be recognized, becomes an expensive item

²⁰⁸R.S.O. 1970, c. 33 as am.

²⁰⁹See, *The Personal Property Security Act*, R.S.O. 1970, c. 344 as am., ss. 2(a) and 1(y).

²¹⁰*Ibid.*, s. 2(b).

²¹¹Gilmore, *Security Interests in Personal Property* (1965), Vol. 1, p. 214.

(but this, like any other business expense, translates itself into an element of price so that this objection is not to be taken seriously). When many claims are to be paid, it is inevitable that mistakes will be made, and if the obligor pays the wrong person he still owes the money to the rightful claimant (but in a large operation this, like the bookkeeping item, is a matter for cost accounting or insurance). Beyond clerical error and routine mistake, there is the problem of deciding whether an assignment is valid, under the law of some state or of a foreign country. Finally, under the normal rule of assignment law, the obligor will not be able to make set-offs against the assignee on account of claims or defenses against the assignor which arise after the obligor has received notification of the assignment. Quite naturally the obligor would prefer to avoid the fuss, the bother, the certainty of mistake, the duty of deciding difficult and obscure questions of law and the possibility of losing rights to resist payment. He therefore writes into his contract, letter of credit or insurance policy a clause to prohibit assignments made without his consent.

This gives one side of the picture. The other side is even more compelling from the assignor's point of view. Prospective book debts constitute a very important form of collateral, and the bank or other lender often requires an assignment of book debts as a condition of making a loan to the supplier. Without access to such secured lines of credit, the supplier frequently would not be able to proceed with the contract.

There is a surprising dearth of Anglo-Canadian case law²¹² with respect to the validity, at common law, of clauses prohibiting assignments. As is shown elsewhere,²¹³ the few cases that do touch on the point are inconclusive.²¹⁴ There appears, however, to be a general willingness to circumvent such clauses without expressly declaring them to be ineffectual. The pre-Code American authorities were much more numerous, but equally ambivalent.²¹⁵ Again, however, there were strong signs of a growing hostility towards recognition of 'no assignment' clauses in response to the economic need for free alienability.²¹⁶

The Code has now firmly swung its support in favour of the free alienability of earned rights under contracts of supply and purchase, as may be seen from the following provisions:

Section 2-210(2) of the Code provides:

(2) Unless otherwise agreed all rights of either seller or buyer

²¹²See, for example, *Re Turcan* (1888), 40 Ch. D. 5 (C.A.); *Spellman v. Spellman*, [1961] 1 W.L.R. 921, [1961] 2 All E.R. 498 (C.A.); *Wickham Holding v. Brooke House Motors*, [1967] 1 W.L.R. 295, [1967] 1 All E.R. 117 (C.A.). The last two cases involved hire-purchase agreements and are not very helpful in determining the validity of 'no assignment' clauses in agreements creating book debts. There appear to be no Canadian cases directly on point.

²¹³See, Carr, footnote 197 *supra*, pp. 25-28.

²¹⁴See now, however, *Helstan Securities Ltd. v. Hertfordshire County Council*, [1978] 3 All E.R. 262 (Q.B.).

²¹⁵See, Gilmore, footnote 211 *supra*, sec. 7.6.

²¹⁶See, UCC 9-318, Comment 4, paras. 4-5.

can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. *A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.* (Emphasis added.)

UCC 9-318 provides:

(4) A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or to become due or requires the account debtor's consent to such assignment or security interest.²¹⁷

We deal hereafter with the first sentence of UCC 2-210(2), and our present discussion is confined to the second sentence and to UCC 9-318(4). Ontario law, including *The Personal Property Security Act*, contains no corresponding provisions.²¹⁸ It will be noted that, while the two subsections overlap to a substantial extent, they are not identical. Section 9-318(4), which is part of the Code's chapter on secured transactions, only applies to a prohibition affecting the assignment of an account, whereas section 2-210(2) covers the assignment of both a right to damages and a right arising out of the assignor's performance of his entire obligation. It seems, therefore, on a literal reading of the last sentence of section 2-210(2), that a buyer would be free to assign the right to delivery of goods for which payment has been made. Whether the draftsmen intended such a result is not clear. In principle, however, there is no reason why the avoidance of 'no assignment' clauses should be restricted to an assignment of accounts. Another distinction between the two subsections arises out of the limitation of section 2-210(2) to rights that have been earned, although it is difficult to gauge its precise impact.

We are of the view that the principle enshrined in section 9-318(4) is sound and that, in the modern commercial context, the creditor's right to deal freely with rights to payment is more important than the account debtor's administrative convenience. We are fortified in our position by the fact that UCC 9-318(4) has now been in force in many of the American states for twenty-five or more years. We also deem it significant that an earlier version of UCC 9-318(4) is now in force in Manitoba.

²¹⁷"Account debtor" is defined in UCC 9-105(1)(a); "account" and "general intangibles" are defined in UCC 9-106. The current version of UCC 9-318(4) differs somewhat from the pre-1972 Official Text. The pre-1972 version read:

(4) A term in any contract between an account debtor and an assignor which prohibits assignment of an account or contract right to which they are parties is ineffective.

The reasons for the change are explained in the Appendix to the 1972 Official Text, "Reasons for 1972 Change", accompanying UCC 9-318.

²¹⁸Note, however, that section 40(4) of the Manitoba *Personal Property Security Act*, S.M. 1973, c. 5, substantially reproduces the pre-1972 Code version of UCC 9-318(4). The Manitoba provision is apparently based on section 40(4) of the Model Uniform Personal Property Security Act adopted by the Canadian Bar Association in September, 1970.

We therefore recommend the addition to section 40 of *The Personal Property Security Act* of a provision comparable to UCC 9-318(4). We also recommend the insertion in the revised Sale of Goods Act of a provision comparable to the second sentence of UCC 2-210(2).²¹⁹ This double barrelled approach is necessary to take care of those forms of assignment not caught by the definitions of "account" and "contract right" in Article 9 and in their Ontario counterparts.²²⁰ In recommending this approach we assume that effect will also be given to our earlier recommendation concerning the adoption of a clause similar to UCC 9-104(f).

(d) MODIFICATION OF CONTRACTUAL RIGHTS AFTER ASSIGNMENT²²¹

The general rule is that an assignee takes subject to such equities as may exist between the obligor and assignor at the time the obligor is notified of the assignment, but that he does not take subject to equities that may arise after this event. The meaning of equities in this context is not free of ambiguity. Leaving aside this difficulty, however, it will be seen that, if applied strictly, the rule could preclude, so far as the rights of assignees are concerned, bona fide modifications to the contract made after assignment. Apparently, this was the view held by a divided court in *Brice v. Bannister*.²²² Apart from this decision, there appears to be no Anglo-Canadian authority that deals squarely with the question whether bona fide modifications or substitutions under the contract, after the right to payment has been assigned, are effective against the assignee, and the matter must be regarded as unsettled. A reasonable interpretation of the parties' intention, as well as everyday commercial practice, suggests that an assignment is not meant to freeze rights and obligations under a contract that is still executory. Moreover, these factors suggest that the original contracting parties should be free to make legitimate adjustments until such time as the assigned right has fully matured. This is what UCC 9-318(2) provides with respect to the right to payment under an assigned contract:

²¹⁹See, Draft Bill, s. 4.9(3).

²²⁰The provisions of *The Personal Property Security Act* on this point are unclear.

The Act does not, it would seem, use the term "contract right". The term "account" does appear in the Act, but is not defined. "Account debtor", which is the expression used in section 40 of the Act, is defined in section 1(b) as "a person who is obligated on chattel paper or on an intangible". "Intangible" is defined in s. 1(m) as meaning "all personal property, including choses in action that is not goods, chattel paper, documents of title, instruments or securities". When read in conjunction with s. 40, which is the counterpart to UCC 9-318, this might suggest a much broader reach to s. 40 than is expressed in the Code version and would extend its provisions to assignments of all forms of things in action, whether or not by way of security.

However, this broad construction is difficult to reconcile with s. 2(b) of *The Personal Property Security Act* which, so far as absolute assignments are concerned, confines the Act to an assignment of book debts "not intended as security". "Book debts" is not defined. Presumably, therefore, s. 40 was also intended to be restricted to an assignment by way of security and to absolute assignments of book debts.

²²¹See, Carr, footnote 197 *supra*, pp. 41-50.

²²²(1878), 3 Q.B.D. 569.

(2) So far as the right to payment or a part thereof under an assigned contract has not been fully earned by performance, and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards is effective against an assignee unless the account debtor has otherwise agreed but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.

For some unexplained reason, this provision, too, was omitted from section 40 of *The Personal Property Security Act*. However, it has been adopted in the Model Uniform Personal Property Security Act²²³ and has been recommended for adoption in British Columbia²²⁴ and Saskatchewan.²²⁵ We believe it to be a very useful provision and we recommend its adoption in Ontario.

(e) OTHER ASPECTS OF UCC 2-210

Section 2-210 contains several other provisions, some declaratory of the existing law, and others as aids in construction. Subsection (1) provides as follows:

(1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

This provision also reflects the Anglo-Canadian position.²²⁶ We consider that a similar provision could usefully be incorporated in the revised Act as part of a section dealing with various facets of assignment.

Subsection (2) of UCC 2-210 has already been quoted, and we have previously recommended adoption of the second sentence of the subsection. The first sentence deals with the assignability of the rights of a buyer or seller, which have not yet been earned by performance, and restrictions on the right to assign; namely, where the assignment would "materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance". These restrictions appear to correspond with the restrictions obtaining under the existing Anglo-Canadian law.²²⁷ In our view, the first sentence forms a logical complement to

²²³S. 40(2). The Act was drafted by a Committee of the Canadian Bar Association and was adopted by the Association in 1970. See, Ziegel, "The Model Uniform Personal Property Security Act" (1971), 78 Can. Banker 16. The Act is currently being revised.

²²⁴Law Reform Commission of British Columbia, *Report on Debtor-Creditor Relationships, Pt. V — Personal Property Security* (1975), Appendix A, s. 40(2).

²²⁵Law Reform Commission of Saskatchewan, *Proposals for a Saskatchewan Personal Property Security Act* (July, 1977), s. 40(2).

²²⁶See, Waddams, footnote 157 *supra*, p. 361.

²²⁷See, Treitel, *The Law of Contract* (4th ed., 1975), at pp. 472-74; Friedman, *The Law of Contract in Canada* (1976), at pp. 442-44; *Kemp. v. Baerselman*, [1906] 2 K.B. 604 (C.A.); and, compare, *Tolhurst v. Assoc. Portland Cement Co.*, [1903] A.C. 414 (H.L.).

the second sentence of UCC 2-210(2), and we recommend the adoption of a similar provision in the revised Ontario Act.²²⁸ Subsections (3) and (4) deal largely with questions of construction and provide as follows:

(3) Unless the circumstances indicate the contrary a prohibition of assignment of 'the contract' is to be construed as barring only the delegation to the assignee of the assignor's performance.

(4) An assignment of 'the contract' or of 'all my rights under the contract' or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

The point has been made to us²²⁹ that subsection (3) is superfluous. This would be a persuasive argument if assignment clauses were always clearly drafted; the evidence, however, is otherwise.²³⁰ We therefore favour adopting the subsection. Objection has also been raised²³¹ to the concluding sentence in subsection (4), on the ground that it deals with an aspect of a wider problem that should form part of a general review of the law of third party beneficiaries. As indicated hereafter,²³² we support the desirability of such a general review, but it may take some time to complete. In the meantime, we see considerable merit in adopting the Code provision, particularly in view of the fact that there is already important precedent for it in section 19 of the Ontario Mortgages Act.²³³

Subsection (5) introduces a principle that is new to Anglo-Canadian law. It provides as follows:

(5) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee (Section 2-609).

It will be observed that the provision is only a particularized application of the general right of a party who feels himself insecure to obtain an

²²⁸See, Draft Bill, s. 4.9(2).

²²⁹Carr, footnote 197 *supra*, p. 56.

²³⁰Duesenberg and King, footnote 23 *supra*, p. 4-78.

²³¹Carr, footnote 197 *supra*, p. 57.

²³²*Infra*, this chapter, sec. 10.

²³³R.S.O. 1970, c. 279, s. 19, discussed in Rayner & McLaren, *Falconbridge on Mortgages* (4th ed., 1977), pp. 306 *et seq.* See also *Restatement of the Law, Contracts 2d, Tent. Draft*, s. 160(2).

adequate assurance of performance under section 2-609 of the Code.²³⁴ The general principle is sound and is supported later in this Report.²³⁵ Subsection (5), however, raises a point that requires consideration at this stage: namely, whether the subsection is justified in treating delegation of performance as automatically creating grounds for insecurity by the other contracting party. *Prima facie*, one would have thought that subsections (1) and (2) provide sufficient protection and that, in cases not falling within these provisions, the burden should rest on the other contracting party to justify his demand, as is generally true under UCC 2-609. The Code explains the distinction²³⁶ on the ground that "the non-assigning original party has a stake in the reliability of the person with whom he has closed the original contract and is, therefore, entitled to due assurance that any delegated performance will be properly forthcoming". This argument almost proves too much and, if carried to its logical conclusion, would substantially reduce the value of the power to delegate performance. However, subsection (5) has won the support of commentators²³⁷ and does not appear to have created difficulties in practice. A majority of the Commissioners²³⁸ support it on this ground, as well as on the ground that, since we have recommended adoption of the other parts of section 2-210, there is a persuasive argument for maintaining uniformity on this point as well.

In summary, we recommend adoption in Ontario of provisions similar to UCC 2-210(1), (2), first sentence, (3), (4) and (5), and our Draft Bill so provides.²³⁹

²³⁴UCC 2-609 provides:

(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

²³⁵*Infra*, ch. 18.

²³⁶UCC 2-210, Comment 6.

²³⁷Duesenberg and King, footnote 23 *supra*, pp. 4-79/80.

²³⁸Two of the Commissioners, the Honourable Richard A. Bell and Mr. W. Gibson Gray, do not agree that delegation of performance should be treated as automatically creating grounds for insecurity. Rather, they would require that the non-assigning party have reasonable grounds for insecurity arising out of the assignment delegating performance before he or she is entitled to demand assurances of performance.

²³⁹See Draft Bill, s. 4.9(1), (2), (4), (5) and (7) respectively.

10. PRIVITY OF CONTRACT AND CONTRACTS FOR THE BENEFIT OF THIRD PARTIES

This important topic is the subject of a separate research paper prepared for the Commission.²⁴⁰ Subject to a substantial number of exceptions, it would appear that the common law rule is still solidly entrenched in England and Canada, that no one may sue or be sued on a contract, or enforce a benefit or be subjected to a burden as a result of a contract, unless he is a party to it. This is the familiar doctrine of privity of contract.

The doctrine has been frequently criticized and its abolition was recommended in England before the war by the Law Revision Committee.²⁴¹ The research paper prepared for the Commission finds much of the criticism justified, and contains a detailed consideration of the basis of desirable reform and the rules governing the new tripartite relationship. The paper also concludes,²⁴² however, that the doctrine of privity has no uniquely sale of goods dimension, and that the basic changes should be introduced in a Law of Contract Amendment Act or similar enactment of general application.

The Commission agrees with this conclusion, subject to two qualifications. As previously indicated, where the assignee of contractual rights has also undertaken to perform the assignor's duties, we favour allowing the obligee to enforce the undertaking directly against the assignee. The second qualification involves the rights of parties other than the original buyer to enforce express and implied warranties given by a previous seller. In its *Report on Consumer Warranties and Guarantees*,²⁴³ the Commission recommended some important changes in the privity doctrine from this point of view. We have considered whether similar changes should be made in the general law of sale and, as will be seen later,²⁴⁴ give a favourable but heavily circumscribed answer.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. Section 3 of *The Sale of Goods Act* dealing with capacity to contract and contracts with minors and other persons under contractual disability should be retained in the revised Act until such time as comprehensive legislation dealing with contracts with persons under contractual disability is adopted.
2. The revised Act should contain provisions, similar in intent to those in UCC 2-206, to clarify and modernize existing rules with respect to acceptance by performance. We favour a synthesized version of UCC 2-206 and sections 56(2) and 63 of the *Second Restatement on Contracts*, so that the meaning of the new pro-

²⁴⁰Carr, "Privity of Contract", Research Paper No. II.6.

²⁴¹Law Revision Committee, *Sixth Interim Report*, footnote 59 *supra*, paras. 41-49.

²⁴²*Supra*, footnote 240, p. 87.

²⁴³*Supra*, footnote 172, at pp. 76 *et seq.*

²⁴⁴*Infra*, ch. 10.

visions will be clear to the Ontario practitioner, without the need for extended research into their American origins and judicial interpretation. In particular, the new section should provide that, unless otherwise indicated by the language or circumstances,

- (a) (i) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances including performance of the requested act;
 - (ii) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods, except that a shipment of non-conforming goods shall not be treated as an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer;
 - (b) where an offer is accepted by performance and the offeree has reason to know that the offeror has no adequate means of learning of the performance with reasonable promptness and certainty, the contractual duty of the offeror shall be discharged
 - (i) unless the offeree exercises reasonable diligence to notify the offeror of acceptance;
 - (ii) unless the offeror learns of the performance within a reasonable time; or
 - (iii) unless the offer indicates that notification of acceptance is not required;
 - (c) where an offer invites an offeree to choose between acceptance by promise and acceptance by performance, the tender or beginning of the invited performance or a tender of a beginning of it is an acceptance by performance; and
 - (d) such an acceptance shall operate as a promise to render complete performance.
3. (a) With the exception of subsection (3), the provisions of UCC 2-207 dealing with the use of conflicting forms to record the terms upon which the parties are willing to enter into a contract, should not be adopted in the revised Act. This recommendation is without prejudice to further study of the problem in the Law of Contract Amendment Project.
 - (b) A provision similar to subsection (3) of UCC 2-207 should be included in the revised Act as a means of construing the terms of a contract where the parties have exchanged conflicting forms, but have proceeded to act as if there were a binding contract.
4. Sales by auction should be dealt with in a revised version of section 56 of the existing Act, which should incorporate the following new features:

- *(a) A sale by auction shall be deemed to be with reserve unless the goods are put up without reserve;
 - (b) It should be made clear that, in an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time;
 - **(c) The section should provide that in an auction with or without reserve the bidder may retract his bid until the auctioneer announces the completion of the sale, and that a bidder's retraction does not revive any previous bid;
 - (d) Where a seller makes a secret bid at an auction, the remedies of the buyer should be clarified so as to encompass the right to recover damages or claim an abatement in the price, as well as to avoid the sale; and
 - (e) The prohibition against a seller making an undisclosed bid should not apply in the case of a forced sale.
5. An offer by a merchant to buy or sell goods which expressly provides that it will be held open should not be revocable for lack of consideration during the time stated or, if no time is stated, for a reasonable period not to exceed three months.
- ***6. Writing should not be a condition of enforceability of a firm offer not supported by consideration.
7. The revised Act should include a provision, similar to UCC 2-209, abolishing the need for consideration to support an agreement made in good faith modifying the terms of an existing contract.
- ****8. Such an agreement should not be required to be in writing unless the contract being modified contains such a requirement.
9. The revised Act should make it clear, following UCC 2-209(4) and (5), that, even though an attempt at modification or rescission of the contract does not satisfy the requirement for a signed writing in the original agreement, it may operate as a waiver or equitable estoppel.
10. Section 16 of *The Mercantile Law Amendment Act* should be deferred for study by the Law of Contract Amendment Project.
11. A provision similar to UCC 2-203 depriving a sealed writing evidencing a contract of sale of any special effect should not be included in the revised Act. Any change in the law of sealed writings should await the outcome of a comprehensive review

*The Honourable Richard A. Bell and the Honourable J. C. McRuer dissent from this recommendation. See footnote 49, *supra*.

**The Honourable Richard A. Bell dissents from this recommendation. See footnote 57, *supra*.

***The Honourable J. C. McRuer and W. Gibson Gray dissent from this recommendation. See footnote 73, *supra*.

****The Honourable J. C. McRuer and W. Gibson Gray dissent from this recommendation. See footnote 116, *supra*.

of the doctrine of consideration and the enforceability of gratuitous promises.

12. With respect to the doctrine of mistake in the law of sales:
 - (a) A provision similar to UCC 2-613 should be adopted in the revised Act in place of section 7 of *The Sale of Goods Act* with respect to the effect of the parties' mistaken assumption as to the existence of the goods. The new section should, however, make it clear that its provisions can be rebutted by evidence of a contrary intention by the parties, and that the seller will not be excused from non-performance if he has behaved negligently.
 - (b) The distinction between void and voidable titles arising from a mistake with respect to the identity or attributes of the other contracting party should be abolished, and all such mistakes should be treated as creating a voidable title.
 - (c) Wider proposals for reform of the doctrine of mistake should be deferred for study by the Law of Contract Amendment Project.
 13. (a) The Statute of Frauds provision, contained in section 5 of the existing Act, should be omitted from the revised Sale of Goods Act.
 - (b) This recommendation is confined to contracts for the sale of goods, and no opinion is expressed with respect to the desirability of retaining Statute of Frauds requirements with respect to other types of contract.
- *****14. The parol evidence rule should not apply to contracts for the sale of goods, and a provision in a writing purporting to state that the writing represents the exclusive expression of the parties' agreement should have no conclusive effect.
15. Abolition of the parol evidence rule need not be accompanied by special provisions dealing with the position of third parties claiming rights under a written contract of sale.
 16. As an aid in construing the terms of an agreement and establishing the relative priority of express terms, course of performance, course of dealing and usage of trade, there should be included in the revised Act provisions, comparable to those contained in UCC 2-208, admitting evidence of how the parties applied the agreement in practice.
 17. There should be a general review of the formalities governing assignments of choses in action in Ontario with a view to their rationalization and modernization.
 18. The transfer of a right to payment under a contract to an assignee who is also to perform the obligations under the con-

*****The Honourable J. C. McRuer dissents in part from this recommendation.
See footnote 182, *supra*.

tract, should be excluded from the operation of *The Personal Property Security Act*. Accordingly, consideration should be given to the inclusion in that Act of a provision similar to UCC 9-104(f).

19. In order to permit creditors to deal freely with rights to payment, terms in a contract of sale prohibiting assignment of accounts should be rendered ineffective. Accordingly,
 - (a) a provision comparable to UCC 9-318(4) should be added to section 40 of *The Personal Property Security Act*; and,
 - (b) a provision along the lines of the second sentence of UCC 2-210(2) should be inserted in the revised Sale of Goods Act.
20. In order to make it clear that bona fide modifications of, or substitutions for, a contract after the right to payment has been assigned are effective against the assignee, a provision comparable to UCC 9-318(2) should be included in *The Personal Property Security Act*.
21. There should be included in the revised Sale of Goods Act the following features of UCC 2-210:
 - (a) subsection (1), which reflects the existing law concerning delegation of performance;
 - (b) subsection (2), first sentence, which reflects existing law concerning the assignability of the rights of a buyer or seller, other than rights earned by performance, and the restrictions thereon;
 - (c) subsection (3), dealing with the construction of terms prohibiting assignment of "the contract";
 - (d) subsection (4), dealing with the construction of an assignment of "the contract" or of "all my rights under the contract" or similar terms;
 - ***** (e) subsection (5), entitling the other party to a contract to treat an assignment delegating performance as creating reasonable grounds for insecurity and to demand assurances from the assignee.
22. Because the doctrine of privity of contract has no unique sale of goods dimension, any basic changes in the doctrine, so far as it affects the rights of third parties should, with two exceptions, be introduced in a Law of Contract Amendment Act or similar enactment of general application. The exceptions to this recommendation involve assignments of contractual rights where the assignee has also undertaken to perform the assignor's duties, and the rights of parties other than the original buyer to enforce warranties given by a previous seller.

*****The Honourable Richard A. Bell, and W. Gibson Gray dissent from this recommendation. See, footnote 238, *supra*.

PART IV

GENERAL OBLIGATIONS AND CONSTRUCTION OF THE CONTRACT

INTRODUCTION

Every contract of sale contains a common core of obligations. Expressed succinctly, the seller's obligation is to deliver goods of the right quantity, quality and description and at the right time and place; the buyer's obligations are to accept delivery and to pay for the goods. It is rare for the parties to spell out in detail their respective obligations, and one of the tasks long assumed by the courts has been to fill in the gaps where the contract itself is silent. Alternatively, the courts have been required to flesh out the skeletal provisions of a contract where they lack sufficient detail.

The Sale of Goods Act codified the results of this judicial activity, but not exhaustively. Article 2 has built upon this base, but has enlarged it considerably in at least three directions: namely, (a) by adding to the number of implied terms or providing constructional rules for the interpretation of express terms; (b) by imposing important behavioural baselines of reasonableness and fairness, and indicating more specifically the admissibility of disclaimer clauses; and, (c) by attempting to provide a bridge between traditional sales law and the newly burgeoning area of products liability law.

Several important obligational and constructional questions have already been dealt with in the preceding parts of this Report. Others will be examined in Part V. This part of the Report will confine its attention to the following topics: (1) the definition of express warranty and the classification of contractual obligations; (2) doctrines of unconscionability and good faith as imposing restrictions on the parties' freedom of contract, and as providing baselines for the performance and enforcement of contractual and statutory rights and duties; (3) some specific constructional issues arising in important types of contract, as well as the role of usages of trade and course of dealing in supplementing express terms; (4) the seller's implied warranties and the treatment of disclaimer clauses; and, (5) express and implied warranties and the doctrine of privity. Some of these questions were also examined in 1972 in our *Report on Consumer Warranties and Guarantees in the Sale of Goods*. It is not necessary, therefore, to retrace the same ground in detail. We must, however, take into consideration subsequent developments, and indicate to what extent different rules may be desirable for consumer and non-consumer transactions.

CHAPTER 6

DEFINITION OF EXPRESS WARRANTY AND CLASSIFICATION OF CONTRACTUAL OBLIGATIONS

A. DEFINITION OF EXPRESS WARRANTY

1. RECAPITULATION

It is customary to think of a contract of sale as a discrete phenomenon, occurring within an easily identifiable time frame and isolated from all distracting influences.¹ This legal model gives a very incomplete picture of what frequently happens in practice. If the parties have entered into a formal contract, it may well have been preceded by lengthy negotiations. Further, whether or not there is a written contract, the decision by the seller or the buyer to enter into contractual relations will often be influenced by representations of one kind or another, whether conveyed verbally or through such written media as advertisements, sales literature, catalogues, or personal correspondence. This phenomenon raises two important questions. The first is to what extent evidence of such representations is admissible. This question has been discussed earlier.² The second question may be stated in this way: to what extent can the representations be treated as terms of the contract or, more accurately, as express warranties. To this latter question we now turn our attention.

The distinction between contractual and non-contractual representations is an important one. As we have pointed out in our *Report on Consumer Warranties and Guarantees*,³ where there is breach of a non-contractual representation the representee's remedy is normally restricted to the equitable remedy of rescission; that is, unless the representor has been guilty of fraud or of negligence under the *Hedley Byrne* doctrine.⁴ Breach of a term of the contract, on the other hand, will entitle the buyer to sue for damages or to rescind and sue for damages depending on the characterization of the term that has been breached. The authoritative rule adopted by the House of Lords in *Heilbut, Symons & Co. v. Buckleton*,⁵ is that a mere affirmation of fact does not become a term of the contract, unless it was intended to be promissory in character. This test is both elusive and difficult to apply in practice, and it has been frequently criti-

¹For a general discussion of the classification of contractual and non-contractual obligations, see, Waddams, "The Classification of Contractual and Non-Contractual Obligations", Research Paper, No. III.2.

²*Supra*, ch. 5, sec. 7.

³Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), ch. 2, section 1, pp. 28-29.

⁴*Hedley, Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465 (H.L.). Concerning the application of the doctrine in a contractual setting, see *infra*, this chapter, section A. 2-3.

⁵[1913] A.C. 30 (H.L.).

cized.⁶ The *Warranties Report* therefore recommended⁷ the abolition of this test and the substitution in its place of the following definition of warranty found in section 12 of the *Uniform Sales Act*:

Any affirmation of fact or any promise by the seller relating to the goods is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon.

Our Report did not favour the compromise solution adopted in the U.K. *Misrepresentation Act 1967*, and we thought that section 12 was preferable to the more obscure definition in section 2-313(1)(a) of the *Uniform Commercial Code*. That section provides as follows:

2-313(1)(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

The Commission's recommendations on this point appear to have been substantially implemented in Bill 110, introducing *The Consumer Products Warranties Act, 1976*.⁸ The Bill has not, however, been enacted.

With the aid of a background research paper,⁹ we have re-examined this question from the perspective of general sales law. Subject to the qualifications noted hereafter, we have reached the conclusion that a similar definition of express warranty should be adopted in the revised Sale of Goods Act. The New South Wales Working Paper¹⁰ contains a similar recommendation. We do not anticipate that our recommendation will make much practical difference in the case of representations made by merchant sellers, since both Canadian and English courts have shown a ready willingness to characterize such representations as warranties and, indeed, have intermittently used language similar to the American reliance test.¹¹ Our recommendation may, however, effect a change in the case of representations by non-merchant sellers, since the courts have evinced a

⁶See, for example, Allan, "The Scope of the Contract" (1967), 41 A.L.J. 274; Sutton, "Reform of the Law of Sales" (1969), 7 Alta. L. Rev. 130; and, compare, Greig, "Misrepresentations and Sales of Goods" (1971), 87 L.Q.R. 179. See also *Esso Petroleum Ltd. v. Mardon*, [1976] Q.B. 801, at p. 817, [1976] 2 All E.R. 5 at p. 13 (C.A.), *per* Lord Denning, M.R.

⁷Supra, footnote 3, at p. 29.

⁸Bill 110, 3rd. Sess., 30th Legislature. S. 1(1)(c) of the Bill defined "express warranty" as "an affirmation of fact or promise relating to the quality, condition, quantity, performance or efficacy of a consumer product or relating to its use and maintenance where the tendency of such affirmation is to induce the buyer to purchase the consumer product". See, also, the broad definition of "express warranty" in the Saskatchewan *Consumer Products Warranties Act, 1977*, S.S. 1976-77, c. 15, s. 8.

⁹Supra, footnote 1.

¹⁰Law Reform Commission, New South Wales, *Working Paper on the Sale of Goods* (1975), para. 3.44.

¹¹*Benjamin's Sale of Goods* (1974), para. 746; New South Wales Working Paper, *supra*, para. 3.37; *Quaker Oats Co. of Canada Ltd. v. Kitzul* (1966), 53 D.L.R. (2d) 630 (Sask. Q.B.); *Sealand of the Pacific Ltd. v. Ocean Cement Ltd.* (1973), 33 D.L.R. (3d) 625 (B.C.S.C.), aff'd in part and rev'd in part *sub nom. Sealand of the Pacific v. Robt. C. McHaffie Ltd.* (1974), 51 D.L.R. (3d) 702 (B.C.C.A.).

greater reluctance to characterize representations of this kind as warranties.¹² However, we would expect the change to be beneficial because, by characterizing the representation as a warranty, the courts would have at their disposal a wider range of remedies. Further, while our conclusion in favour of the *Uniform Sales Act* test is based on principle and not simply a desire for consistency (either between related Ontario legislation or between Ontario law and the law of other jurisdictions), it would obviously create difficulties if substantially different tests were adopted for consumer and non-consumer warranties.

In our opinion, it would not be satisfactory simply to copy section 12 of the *Uniform Sales Act*. Accordingly, we proceed to discuss several difficulties presented by the American definition, as well as a number of related issues arising out of the revision of this branch of sales law.

2. DEFINITIONAL ISSUES

(a) CHARACTER OF REPRESENTOR

Section 12 of the *Uniform Sales Act* only applies to warranties given by a seller. While representations by a buyer that induce the seller to enter into the contract are no doubt much less common,¹³ there is no reason why the definition should not apply equally to sellers and buyers. We so recommend and our Draft Bill so provides. Section 12 draws no distinction between express warranties given by merchants and non-merchants, and, as already indicated, we support this approach. However, the application of a uniform test raises a controversial question with respect to the remedies that should be available against a non-merchant seller or buyer for breach of express warranty. We examine this issue in a later section.¹⁴

An issue that is not dealt with in section 12 is the liability of a manufacturer or other person in the distributive chain for breach of express warranty, where there is no privity of contract between him and the buyer, although the warranty was addressed to the buyer. We noted in the *Warranties Report*,¹⁵ that Anglo-Canadian courts have surmounted this difficulty by the concept of a collateral warranty, whereas American courts have relied on the hybrid origins of the action in warranty as an action on the case in deceit. Whichever rationale is preferred, we think it should be made clear that the definition of express warranty applies to representations and promises made by "the seller, manufacturer or distributor of the goods",¹⁶ whether or not there is privity of contract between the

¹²See, for example, *Oscar Chess Ltd. v. Williams*, [1957] 1 All E.R. 325 (C.A.).

¹³Compare, *Goldsmith v. Rodger*, [1962] 2 Lloyd's Rep. 249 (C.A.).

¹⁴*Infra*, this chapter, sec. A. 2(h).

¹⁵*Supra*, footnote 3, ch. 5, pp. 65 *et seq.*, and see, also, the important decision of Reid, J., in *Sperry Rand Corp. et al.* (a decision of the Ontario High Court of Justice, dated January 12, 1979, as yet unreported).

¹⁶See, Draft Bill, s. 5.10(1). We prefer this formulation to the proposal in the New South Wales Working Paper that the definition should be applied to representations made by a person who has a "connection in the course of business" with goods of the description to which his representation relates: see footnote 10 *supra*, pp. 287-89, s. 15. Such types of person are broadly defined in the proposed New South Wales Draft Bill, s. 4(c)(iv), adding a new s. 5(5) to the *Sale of Goods Act*, 1923. See especially clause (f).

representor and the representee. We do not deem it necessary to define manufacturer, and our Draft Bill contains no definition of this term. The underlying theme of the expanded definition is to capture representations by persons involved in the distribution of the goods and, in our opinion, this should provide sufficient guidance for its application.

(b) TYPES OF REPRESENTATION

Section 12 of the *Uniform Sales Act* applies to any "affirmation of fact or any promise". "Affirmation of fact" sounds a little formal, and we have a modest preference for "representation", a term that is also used in section 36 of the *Combines Investigation Act*.¹⁷ Accordingly, we recommend that the definition of express warranty should apply to representations or promises relating to goods that are the subject of a contract of sale.

(c) TIME OF REPRESENTATION

Section 12 does not address itself directly to the question of the time at which the representation must be made. Inferentially, however, the representation must be made before, or at the time of, sale; otherwise, the buyer would not be able to show that the representation induced him to make the purchase. As will be seen, the reliance requirements that we propose are different. In our Draft Bill we have, however, retained the temporal elements in order not to make the definition too open-ended. Admittedly, the restriction of the definition to representations made before, or at the time of, sale will exclude post-sale representations. These types of case can, however, be treated (as they have been treated in some American cases)¹⁸ as modifications of the contract of sale or under broader reliance doctrines.

(d) DEEMED ADOPTION OF REPRESENTATION BY OTHERS

Our *Warranties Report*¹⁹ discussed the difficult problem of whether a retailer should be deemed to adopt the contents of labelling and other descriptive materials attached to or accompanying goods sold but not prepared for or by him. We favoured an affirmative answer. We did not, however, suggest that the retailer's liability should extend beyond this relatively circumscribed area; nor were we addressing ourselves to non-consumer warranties. Section 7(2) of Bill 110 would have gone beyond our recommendations and would have held the retailer jointly responsible with the manufacturer for any written, published or broadcast warranties given by a manufacturer. Whatever may be the merits of this rule in the context of consumer warranties, we think it too harsh to be applied to sellers generally, and do not recommend its adoption in the case of non-consumer sales. Indeed, in a later chapter,²⁰ we recommend in our draft

¹⁷R.S.C. 1970, c. C-23, as amended by S.C. 1974-75-76, c. 76. "Representation" is also used in the New South Wales draft section, footnote 16 *supra*.

¹⁸See, for example, *Bigelow v. Agway, Inc.* (1974), 15 U.C.C. Rep. 769. (C.A. 2); and compare, Hutzler, "'Basis of the Bargain' — What Role Reliance?" (1972-73), 34 U. Pitts. L. Rev. 145.

¹⁹Supra, footnote 3, pp. 34-35.

²⁰Infra, ch. 9, sec. 2.

provision dealing with the warranty of description²¹ that "a description of the goods given by a third person is binding on the seller only if by his words or conduct he has adopted the provision as his own".²² This clearly militates against the underlying theory of section 7(2).

(e) THE RELIANCE FACTOR

Section 12 of the *Uniform Sales Act* sets forth, in this context, a double test: the buyer must show that "the natural tendency" of the seller's representation is to induce the buyer to purchase the goods, *and* that the representation actually induced him to make the purchase. We have no quarrel with the first requirement, but the second gives rise to acute difficulties when applied to a manufacturer's performance warranty. Frequently the buyer will not see the warranty until after his purchase, either because the warranty document is contained inside the packaging, or because the retailer only hands it to him at the time of delivery of the goods. Another common example involves goods bought in a self-service store, where the buyer does not carefully examine the labelling until he has brought the goods home or is ready to use them. In all these cases the buyer would have some difficulty in satisfying the second reliance requirement, and the representor may be able to escape responsibility for a representation that was clearly intended to be relied upon. We do not think that this would be a satisfactory or sensible result. Accordingly, we recommend that proof of actual reliance by the representee be dispensed with where the representation or promise is made to the public.²³

Several precedents support this distinction. One is section 36 of the *Combines Investigation Act*,²⁴ which penalizes false or misleading representations made to the public. A second precedent is found in sections 14 and 15 of the present Sale of Goods Act relating to the implied conditions of description and merchantability. In neither case is it necessary for the complainant to prove actual reliance on the express or implied representation; the reliance is assumed. We note, too, that both Bill 110²⁵ and the Saskatchewan Consumer Products Warranties Act, 1977²⁶ dispense with proof of actual reliance for all types of express warranties, public or private.

(f) NEGLIGENCE AS A MATERIAL FACTOR

In *Dick Bentley Productions Ltd. v. Harold Smith (Motors) Ltd.*,²⁷

²¹Draft Bill, s. 5.11.

²²See, however, the qualification to this proposition introduced in our definition of the warranty of merchantability, Draft Bill, s. 5.13(1). See also *infra*, ch. 9, sec. 3(b)(vi).

²³See, Draft Bill, s. 5.10(1)(b). This recommendation would also alleviate the difficulties faced by the plaintiffs in *Naken et al. v. General Motors of Canada and Vauxhall Motors Ltd.* (October 12, 1978, Ontario Court of Appeal, as yet unreported), reversing (1977), 17 O.R. 193 (Div. Ct.), in being required to prove actual reliance on General Motors' advertisements as an essential ingredient of their cause of action.

²⁴*Supra*, footnote 17.

²⁵*Supra*, footnote 8, ss. 1(1)(c), 7.

²⁶S.S. 1976-77, c. 15, s. 8(1).

²⁷[1965] 1 W.L.R. 623 (C.A.), 627.

Lord Denning, M.R., suggested that negligence, or its absence, could make a difference in determining whether a representation that otherwise induces detrimental reliance amounts to a warranty. This suggestion has been criticized,²⁸ and rightly so in our opinion, as introducing an extraneous and novel consideration into the law of warranties. We do not support its introduction as an element in the statutory definition of express warranty. It is well settled²⁹ that the warranties implied under *The Sale of Goods Act* impose strict liability, and that the seller cannot excuse himself by showing that he was ignorant of the defect and could not have discovered it by the exercise of reasonable care. In our view, serious anomalies would be created if a different test were to be adopted for express warranties.

(g) LANGUAGE OF COMMENDATION

Section 12 of the *Uniform Sales Act*³⁰ and UCC 2-313(2) contain a proviso to the effect that mere language of commendation shall not be construed as a warranty. We did not support this exclusion in the *Warranties Report*³¹ and we do not support it in the wider context of a revised Sale of Goods Act. In our view, if a buyer has reasonably relied on the accuracy of a representation, it ought surely not to be open to the representor to argue that he was merely exercising a salesman's poetic licence. This is the thrust of the decisions³² on the misleading advertising provisions in the *Combines Investigation Act*, and we believe their reasoning is just as valid in the civil context.

(h) MEASURE OF DAMAGES FOR BREACH OF A NON-PROMISSORY WARRANTY

The effect of treating every material representation as an express warranty is to expose the representor to the same measure of damages for its breach as for breach of any other term of the contract. This means that the representor could be liable for expectation and reliance losses, and for consequential as well as direct damages. The Commission has considered the implications of this change in the case of representations made by a private seller, and the possibility of drawing a distinction between commercial and private sales.³³ In the first case, the normal rule of damages would be applied; but, in the case of private sales, the seller's liability would only be assessed on a restitutionary or some similar out-of-pocket basis, unless the warranty was promissory in character.

While we are fully conscious of the problem, we have decided not to

²⁸Benjamin's *Sale of Goods* (1974), para. 746, p. 333, note 1; New South Wales Working Paper, footnote 10 *supra*, sec. 3.39.

²⁹*Frost v. Aylesbury Dairy Co. Ltd.*, [1905] 1 K.B. 608 (C.A.); *Buckley v. Lever Bros.*, [1953] O.R. 704, [1953] 4 D.L.R. 16 (H.C.J.).

³⁰The proviso to s. 12 of the *Uniform Sales Act* provides as follows: "No affirmation of the value of the goods, nor any statement purporting to be a statement of the seller's opinion only shall be construed as a warranty."

³¹*Supra*, footnote 3, p. 29.

³²The case law is reviewed in Minter, "Misleading Advertising: the Standard of Deceptiveness" (1976), 1 C.B.L.J. 435.

³³See, Waddams, footnote 1 *supra*, pp. 25 *et seq.*

recommend adoption of this distinction. It seems to us an elusive test, and one that is likely to raise the same difficulties as the present distinction between contractual and non-contractual representations.³⁴ Moreover, the concern that the definition of warranty may give rise to extended liability in the case of private sales may be unfounded. As our research indicates,³⁵ there are few reported cases in which the American courts, basing themselves on the expanded definition of warranty in the *Uniform Sales Act*, have awarded consequential damages against a private seller.

It may be that a different rule of damages should be adopted generally in non-commercial sales, and this possibility is explored in chapter 17 of this Report. In our opinion, however, the distinction should not turn on the elusive test of the representor's promissory intentions.

(i) SHOULD THE EXPANDED DEFINITION OF WARRANTY BE APPLIED TO OTHER TYPES OF CONTRACT?

Our proposals for a new definition of warranty are limited to the sales area. We have not considered whether they should be extended to other types of contract. The research paper prepared for the Commission concludes³⁶ that this question should be deferred for future consideration. The reason given is that other types of contractual transactions, particularly those involving land, may raise different issues, and that a solution apt in the sales field may not always be appropriate in others. The Commission agrees with this conclusion.

(j) CONCLUSION: DRAFT PROVISION

In the light of the above discussion, it may now be appropriate to quote the definition of express warranty that we recommend for adoption in the revised Act:³⁷

- (1) A representation or promise in any form relating to goods that are the subject of a contract of sale made by the seller, manufacturer or distributor of the goods is an express warranty and binding upon the person making it**

³⁴Professor Waddams' own example illustrates the difficulty. If a seller advertises for sale a painting by A. Y. Jackson it would clearly be held to be a sale by description under existing law and the seller would be guilty of breach of a condition if the painting were not by A. Y. Jackson. Compare, *Beale v. Taylor*, [1967] 1 W.L.R. 1193 (C.A.). If, however, the original advertisement had merely referred to a painting "by a member of the Group of Seven" and if, later, in response to an inquiry by the prospective buyer, the seller disclosed A.Y. Jackson's name, should the result be any different? If the seller had himself been misled about the identity of the artist, he might find it odd that he could be held contractually responsible in the first case, but might have a fighting chance in the second. The buyer would be even more mystified by the distinction. The difficulty about applying a promissory test that turns on such linguistic accidents was pointed out long ago by Williston. See Williston, "Representation and Warranty in Sales — *Heilbut v. Buckleton*" (1913), 27 Harv. L. Rev. 1, 10-12.

³⁵We refer here to an unpublished memorandum prepared subsequent to Professor Waddams' Working Paper, footnote 1 *supra*, with respect to the treatment of express representations by private sellers under American law.

³⁶*Supra*, footnote 1, at pp. 71 *et seq.*

³⁷See, Draft Bill, s. 5.10.

- (a) if the natural tendency of such representation or promise is to induce the buyer, or buyers generally if the representation or promise is made to the public, to rely thereon; and
 - (b) if, in the case of a representation or promise not made to the public, the buyer acts in reliance upon the representation or promise.
- (2) Subsection 1 applies to a representation or promise made before or at the time the contract was made and whether or not
- (a) it was made fraudulently or negligently;
 - (b) there is privity of contract between the person making the representation or promise and the buyer;
 - (c) it was made with a contractual intention; or
 - (d) any consideration was given in respect of it.
- (3) This section applies *mutatis mutandis* to a representation or promise made by the buyer.

3. OTHER ISSUES

We consider three such issues. The first issue relates to the continuation of certain equitable remedies. An apparent conflict between decisions of the Supreme Court of Canada and the English Court of Appeal forms the subject matter of the second issue. The third issue deals with the interrelationship of contractual and tortious remedies in the context of an action for deceit or fraudulent misrepresentation.

The first issue may be stated in this way: namely, whether the equitable remedies for misrepresentation inducing the making of a contract of sale should be abolished in the revised Act. Our opinion is against abolition. It may well be that, in future, aggrieved parties may prefer to rely exclusively on the superior remedies available under the revised Act for breach of warranty, or that the courts, by a process of adaptation, will integrate the equitable and statutory remedies.³⁸ In any event, we do not think it necessary, or perhaps wise, to dictate the future of the equitable remedies. In saying this we recognize that at least one New Zealand and one Australian court³⁹ have held, contrary to the long established practice of English and Canadian courts, that the Sale of Goods Act has already excluded the equitable remedies. The supporting reason is that the provision equivalent to section 57(1) of the Ontario Act, in preserving the general principles of law in their application to contracts of sale, only refer to "the rules of the common law". In the leading English case of *Leaf v. International Galleries*,⁴⁰ the question whether a buyer can elect between his statutory and equitable remedies where the representation

³⁸Compare, *Leaf v. International Galleries*, [1950] 2 K.B. 86 (C.A.).

³⁹*Riddiford v. Warren* (1901), 20 N.Z.L.R. 572 (C.A.), foll'd in *Watt v. Westhoven*, [1933] V.L.R. 458; Benjamin, footnote 11, *supra*, para. 737.

⁴⁰*Supra*, footnote 38.

amounts to a term of the contract, was not discussed. This question has, however, now been answered in the representee's favour in section 1(a) of the U.K. *Misrepresentation Act* 1967.⁴¹ We consider below,⁴² in a wider context, whether a similar provision should be inserted in the revised Sale of Goods Act.

The second question is whether the Act should resolve the apparent conflict between the decision of the Supreme Court of Canada in *J. Nunes Diamonds Ltd. v. Dominion Electric Protection Co.*⁴³ and the decision of the English Court of Appeal in *Esso Petroleum Ltd. v. Mardon*.⁴⁴ In the former case, according to one reading of the majority judgment, the Court adopted the proposition that, where there is a contract between the parties, an action cannot be brought in tort for negligent representation arising out of the same set of facts. The converse was held by the English Court of Appeal in the *Mardon* case. It may be that *J. Nunes Diamonds* can be distinguished on its facts⁴⁵ but, whether this is so or not, we find the reasoning in the *Mardon* case more persuasive. We know of no sound reason in policy why the existence of a contract should preclude an aggrieved party from pursuing any extra-contractual remedies the law may confer upon him independently of the contract, unless the contract itself so provides. Nor do we think that a distinction can, or should, be drawn between an action for negligent representations inducing the formation of a contract, and other types of tort. However, we do not believe it necessary for the revised Act to refer specifically to claims in negligence under the *Hedley Byrne* rule.⁴⁶ We recommend instead a broader expression of principle to the following effect:

The rights of action of an aggrieved party arising otherwise than in contract are not affected by the existence of a contract of sale unless the contract itself so provides.⁴⁷

The third issue is still more controversial. It involves the question whether, in an action for deceit or fraudulent misrepresentation arising out of a contract of sale, the plaintiff should be able to meld his contractual

⁴¹1967, c. 7. Section 1 provides:

Where a person has entered into a contract after a misrepresentation has been made to him, and —

(a) the misrepresentation has become a term of the contract; or
(b) the contract has been performed;

or both, then, if otherwise he would be entitled to rescind the contract without alleging fraud, he shall be so entitled, subject to the provisions of this Act, notwithstanding the matters mentioned in paragraphs (a) and (b) of this section.

⁴²*Infra*, pp. 144-45.

⁴³[1972] S.C.R. 769.

⁴⁴[1976] Q.B. 801, [1976] 2 All E.R. 5 (C.A.), discussed in Ziegel, "Commentary", (1976), 1 C.B.L.J. 259. See, also, *Batty v. Metropolitan Property Realizations Ltd.*, [1978] 2 W.L.R. 500, [1978] 2 All E.R. 445 (C.A.).

⁴⁵It was so distinguished in *Sodd Corp. Inc. v. Tessis* (1977), 17 O.R. (2d) 158, 79 D.L.R. (3d) 632 (C.A.); and see, also, *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.* (1978), 19 O.R. (2d) 380 (H.C.J.), and, generally, Schwartz, "Hedley Byrne and Pre-Contractual Misrepresentations: Tort Law to the Aid of Contract" (1978), 10 Ottawa L. Rev. 581.

⁴⁶*Supra*, footnote 4.

⁴⁷See, Draft Bill, s. 9.20(1).

and tortious remedies, and thus recover any expectation or "loss of bargain" damages appropriate to a claim for breach of warranty that he may have suffered. Alternatively, should the plaintiff be put to his election and be permitted to recover only his out of pocket losses if he elects to sue in tort? The latter rule represents the existing Anglo-Canadian law.⁴⁸ A majority of the American state courts that have considered the question permit recovery of loss of bargain damages.⁴⁹ The Anglo-Canadian rule is based on the normal principle that the purpose of the law of tort is to compensate the plaintiff for losses sustained, and not to give him the benefit of a contractual bargain. The reasoning supporting the majority American position has been persuasively argued in the following passage:⁵⁰

The plaintiff thought he was entering a transaction which would gain for him certain economic advantages. This is the very function of a contract. His belief, and the action taken pursuant thereto, were justifiable. He has failed to obtain the advantage, the expectation of which induced him to enter the transaction. If he has dealt with the defendant as the other party to a contract, the amount of his recovery should not depend upon whether he or his lawyer calls the action one 'in contract' or 'in tort'. Whether for breach of warranty or deceit or in any other form of action, if he demands it, it would seem good policy that he recover the value of the reasonable expectation which he has failed to obtain.

Article 2 has swung its support in favour of the majority rule. Section 2-721 provides:

Remedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

We find the American rule much more persuasive than the accepted Anglo-Canadian rule and, accordingly, we recommend its adoption in the revised Ontario Act. Our Draft Bill so provides.⁵¹

The second sentence of UCC 2-721 addresses itself to a related question arising out of doctrines of election. This section makes it clear that a plaintiff who exercises a right of rescission, whether on grounds of fraudulent or innocent misrepresentation or otherwise, is not deemed to waive his right to contractual damages. As will be seen in a later chapter,⁵² the American pre-Code rules on rights of rescission for breach of express or implied warranties were not the same as the Anglo-Canadian rules. It is fair to say, however, that in both jurisdictions rescission is an ambivalent

⁴⁸*Doyle v. Olby (Ironmongers) Ltd.*, [1969] 2 Q.B. 158 (C.A.); *Parna v. G. & S. Properties Ltd.*, [1969] 2 O.R. 346, 5 D.L.R. (3d) 315 (C.A.); *McGregor on Damages* (13th ed., 1972), paras. 908-09.

⁴⁹*Prosser, The Law of Torts* (4th ed., 1971), p. 734; *Annot.*, (1940), 124 A.L.R. 37; *Selman v. Shirley* (1938), 85 P. 2d 384.

⁵⁰*Harper & McNeely, "A Synthesis of the Law of Misrepresentation"* (1937-38), 22 Minn. L. Rev. 939, 964.

⁵¹Draft Bill, s. 9.20(2).

⁵²*Infra*, ch. 17, sec. C. 1(b).

term that has been a fertile source of confusion. We find the second sentence a useful provision and also recommend adoption of a similar provision in the revised Act.⁵³

B. CLASSIFICATION OF CONTRACTUAL OBLIGATIONS

A distinctive feature of the present Sale of Goods Act is its division of contractual obligations into conditions and warranties. "Condition", a notoriously ambiguous term,⁵⁴ is used in several senses in the Act, but is not defined anywhere. "Warranty", which is also a term with multiple meanings, is defined in section 1(1)(n) as "an agreement with reference to goods that are the subject of a contract of sale but collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated". The distinction, then, between a warranty and a condition is that breach of a warranty only gives rise to a claim in damages, whereas breach of a condition, as emerges from section 12(2) and other parts of the Act,⁵⁵ entitles the aggrieved party to rescind the contract and to claim damages, or to do either.⁵⁶

This dichotomous classification of obligations into warranties and conditions appears to have its origins in the attempts by Lord Mansfield in the late 18th century⁵⁷ to mitigate the rigours of the law of covenants. In this evolution, the right of an aggrieved party to treat the contract as at an end was restricted to circumstances where the breach by the other involved a "dependent" covenant and the breach was fundamental in nature. These developments merely mirrored a problem with which all legal systems must come to grips: namely, the remedies to be afforded for different breaches of contract. There was, however, a peculiarity about English sales law, as it developed during the 19th century.⁵⁸ Having once categorized a term as amounting to a condition or warranty for the purposes of one contract, the classification was then adopted as binding in later cases involving other contracts of sale and without regard to the severity of the breach in the individual case. This was particularly true of the great terms of title, description, merchantability and fitness, imported in the buyer's favour, and later reproduced in sections 12 to 15 of the U.K. Act.

While there may be some terms whose breach will so seriously prejudice the other party's position that they may fairly be treated as es-

⁵³See, Draft Bill, s. 9.20(3).

⁵⁴Benjamin, footnote 11 *supra*, paras. 753 *et seq.*; Stoljar, "The Contractual Concept of Condition" (1953), 69 L.Q.R. 485. The various meanings of the term are also discussed in *L. Schuler A.G. v. Wickman Machine Tool Sales Ltd.*, [1974] A.C. 235, [1973] 2 W.L.R. 638 (H.L.).

⁵⁵For example, ss. 29, 30, 51.

⁵⁶Note, however, the restriction imposed by s. 12(3) on the right to reject in the case of a sale of specific goods.

⁵⁷In *Boone v. Eyre* (1777), 1 H.B. 273a, 126 E.R. 160 (C. Pleas). See, generally, *Hong Kong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.*, [1962] 2 Q.B. 26 (C.A.), 65-73; and compare *Cehave N.V. v. Bremer Handelsgesellschaft m.b.H.*, [1976] 1 Q.B. 44 (C.A.), *per Denning, M.R.*, at pp. 57-59.

⁵⁸Compare, Devlin, "The Treatment of Breach of Contract", [1966] Camb. L.J. 192, especially at pp. 196-97.

sential terms, this is more likely to be the exception than the rule. As Lord Justice Diplock pointed out in a leading case:⁵⁹

There are, however, many contractual undertakings of a more complex character which cannot be categorised as being 'conditions' or 'warranties', if the late nineteenth-century meaning adopted in the Sale of Goods Act, 1893 . . . be given to those terms. Of such undertakings all that can be predicated is that some breaches will and others will not give rise to an event which will deprive the party not in default of substantially the whole benefit which it was intended that he should obtain from the contract; and the legal consequences of a breach of such an undertaking, unless provided for expressly in the contract, depend upon the nature of the event to which the breach gives rise and do not follow automatically from a prior classification of the undertaking as a 'condition' or a 'warranty'.

The case did not involve a contract for the sale of goods, but these observations seem just as relevant in a sales context.

The *a priori* classification of contractual terms in *The Sale of Goods Act* has come under increasing criticism.⁶⁰ The reason for this criticism is the arbitrary results to which such a classification may give rise, and the encouragement it provides for contrived excuses by a contracting party who wants to relieve himself of a bargain that he no longer finds profitable. It has meant, for example, that a buyer may reject an expensive machine because of a broken glass dial costing only a few cents to replace,⁶¹ or that he may refuse a large shipment of staves because of minor and inconsequential deviations from the contractual description.⁶² The distinction is not generally or consistently adopted in other branches of contract law and it was not adopted in the *Uniform Sales Act*, nor, subsequently, by the draftsmen of the *Uniform Commercial Code*.⁶³ Nor does it appear in the Hague Uniform Law on Sales or the draft sales Convention prepared by UNCITRAL. Recent English decisions also indicate a judicial willingness to erode what had been regarded previously as an impregnable scheme of classification. In *Cehave N.V. v. Bremer Handelsgesellschaft m.b.H.*,⁶⁴

⁵⁹*Hong Kong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.*, footnote 57 *supra*, at p. 70.

⁶⁰Compare, the Ontario Law Reform Commission's *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), p. 31 and New South Wales Working Paper, footnote 10 *supra*, Part 3. See also Waddams, *The Law of Contracts* (1977), pp. 364-66.

⁶¹*I.B.M. v. Shcherban*, [1925] 1 D.L.R. 864 (Sask. C.A.).

⁶²*Arcos Ltd. v. Ronaasen*, [1933] A.C. 470 (H.L.). A system of *a priori* classification may also result in a court denying any remedy where the Act characterizes the term as a condition and the court deems it oppressive to allow the buyer to reject the goods for minor defects. Damages would be an adequate remedy in such a case, but our Act does not vest any discretion in the Court in determining whether or not a right to reject should be allowed once breach of a condition has been established and the buyer purports to reject. Lord Denning's judgment in the *Cehave* case, footnote 57 *supra*, shows clear awareness of this dilemma.

⁶³This is not to suggest that the approach adopted in these laws was or is entirely satisfactory: see *infra*, chapters 16 and 17.

⁶⁴[1976] Q.B. 44 (C.A.), followed in *Tradax International S.A. v. Goldschmidt*, [1977] 2 Lloyd's Rep. 604 (Q.B. Com. Ct.).

the English Court of Appeal held that the Sale of Goods Act did not require the *a priori* classification of express terms of a contract of sale. In a later decision, *Reardon Smith Line Ltd. v. Hansen-Tangen* ("The Diana Prosperity"),⁶⁵ Lord Wilberforce, whose judgment was concurred in by Lord Simon of Glaisdale and Lord Kilbrandon, expressed his dissatisfaction⁶⁶ with earlier cases involving the construction of the implied condition of description.

Even before these trends had emerged, we recommended, in our *Report on Consumer Warranties and Guarantees*,⁶⁷ the abolition of the distinction between warranties and conditions in consumer sales and the substitution of a single term "warranty" to describe the seller's obligations with respect to the attributes of the goods. We also recommended the adoption of a new regime of remedies for breach of warranty obligations that would turn on the gravity of the breach and not on an *a priori* classification of the term breached. The New South Wales Working Paper has, since then, adopted a similar set of recommendations with respect to both non-consumer and consumer sales.⁶⁸

We have again reviewed the position and we are satisfied that our earlier recommendations are as appropriate for general contracts of sale as they are for consumer sales. However, since our earlier recommendations were restricted to consumer warranties, they need to be adapted to meet the broader requirements of the revised Act. We therefore make two recommendations, which are incorporated in our Draft Bill. First, we recommend the elimination of the distinction between warranties and conditions in the revised Act and the substitution of the single term, "warranty", to describe express or implied terms relating to goods. Secondly, we recommend the adoption of a unitary concept of substantial breach to determine the remedies available for breach of contract by the buyer or seller and, in particular, to determine when an aggrieved party may cancel the contract because of breach by the other. We discuss in chapter 18 our recommended definition of substantial breach.

These recommendations will have their primary impact on the buyer's remedies, because the present Act only adopts a system of *a priori* classification with respect to the seller's implied obligations as to title, description, merchantability, fitness, and conformity to sample in cases of sale by sample.⁶⁹ So far as their effect on express obligations is concerned, our recommendations have already been foreshadowed by the recent English decisions mentioned above,⁷⁰ certainly with respect to the seller's obligations and probably also with respect to the buyer's obligations.

The impact of our recommendations on stipulations as to time is a little more speculative, because the existing rules themselves are complex

⁶⁵[1976] 2 Lloyd's Rep. 621 (H.L.).

⁶⁶Ibid., at pp. 626-27.

⁶⁷Supra, footnote 3, p. 44.

⁶⁸Supra, footnote 10, Part 3, especially paras. 3.21, 3.44.

⁶⁹The *Sale of Goods Act*, ss. 13-15; and see, also, s. 29(1) with respect to the seller's obligations as to quantity. Buyer's remedies are dealt with in ch. 17.

⁷⁰Supra, footnotes 64, 65.

and not always clear.⁷¹ Under existing law, breach of a time stipulation in a contract of sale, where time is "of the essence", is breach of a condition, and entitles the aggrieved party to treat the contract as at an end. Section 11 of the Ontario Sale of Goods Act provides as follows:

11. Unless a different intention appears from the terms of the contract, stipulations as to time of payment are not of the essence of a contract of sale, and whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract.

As McCardie, J., observed in an oft-cited passage in *Hartley v. Hymans*,⁷² section 11 does not adequately reflect existing law, since in commercial contracts the well established common law rule (as retained by section 57 of the Ontario Act) long has been that time is *prima facie* of the essence with respect to delivery. Moreover, the presumption in the section that stipulations as to time of payment are not of the essence, while amply supported by authority,⁷³ may also be too broad. It is difficult to reconcile with the rule in section 27 of the Act that delivery and payment are concurrent conditions of the contract of sale, and with the seller's entitlement, pursuant to section 48, to recover loss of bargain damage where the buyer refuses or neglects to accept "and pay" for the goods.⁷⁴ The status of the buyer's obligation to take delivery of the goods where the seller is not to ship them is also unsettled. Section 36 of *The Sale of Goods Act*⁷⁵ leaves the inference that time in such cases is not of the essence. However, decisions on this point⁷⁶ fall on both sides of the line and, unless the goods have been paid for and the seller is merely acting as an involuntary bailee, it is not easy to explain why the buyer's failure to take delivery should be treated more leniently than the seller's failure to make timely delivery.

From this inadequate summary it will be seen that, while existing case law treats some stipulations as to time as *prima facie* essential terms of the contract, there remains a substantial area where there is no presumption with respect to the gravity of a breach or where the position is

⁷¹Compare, Stoljar, "Untimely Performance in the Law of Contract" (1955), 71 L.Q. Rev. 527, especially pp. 531 *et seq.*

⁷²[1920] 3 K.B. 475, at 483-84. See, also, *Warinco v. Samor*, [1977] 2 Lloyd's Rep. 582, 590.

⁷³For example, *Martindale v. Smith* (1841), 1 Q.B. 389; *Decro-Wall International, S.A. v. Practitioners in Marketing Ltd.*, [1971] 1 W.L.R. 361 (C.A.); and compare, *Financings Ltd. v. Baldock*, [1963] 2 Q.B. 104 (C.A.).

⁷⁴Compare, Stoljar, footnote 71 *supra*, at p. 539; and see, also, *Mooney v. Lipka*, [1926] 4 D.L.R. 647 (Sask. C.A.).

⁷⁵Section 36 provides as follows:

36. When the seller is ready and willing to deliver the goods and requests the buyer to take delivery and the buyer does not within a reasonable time after such request take delivery of the goods, he is liable to the seller for any loss occasioned by his neglect or refusal to take delivery, and also for a reasonable charge for the care and custody of the goods, but nothing in this section affects the rights of the seller where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract.

⁷⁶For example, *Woolfe v. Horn* (1877), 2 Q.B.D. 355; *Sharpe v. Christmas* (1892), 8 T.L.R. 687 (C.A.); *Kidston v. Monceau Iron Works Co. Ltd.* (1902), 7 Com. Cas. 82; *Mooney v. Lipka*, footnote 74 *supra*; and compare Atiyah, *The Sale of Goods* (5th ed., 1975), pp. 139-40.

unsettled. Our recommendation in favour of a uniform test of substantial breach would not, in our view, change the position significantly. We would expect the practical results to be the same in most cases, although the reasoning would differ. There would be greater emphasis on the facts of individual cases and the actual prejudice suffered by the aggrieved party, and less reliance on *a priori* assumptions. We would regard such flexibility as a desirable feature of the revised Act.

The difficulty of *a priori* characterization of stipulations with respect to time may be illustrated in the context of the common law rule that time of delivery is *prima facie* of the essence in mercantile contracts. The reason given for the rule⁷⁷ is that the purchase may be a link in a chain of transactions, and that, if the seller does not honour his performance date, the buyer will be in breach of his obligations to his own sub-buyer. This reasoning may be quite valid where the goods are intended for resale, although even in such cases it may be thought that the importance of strictly punctual performance will vary with the nature of the goods, the character of the parties, and the market in which they trade.⁷⁸ Leaving aside this not unimportant qualification, the reasoning clearly does not apply where the goods are bought for use and not for resale. Again, if the test is one of relative prejudice to the parties,⁷⁹ where the goods are made to the buyer's specifications and there is no other ready market for them, the loss faced by the defaulting seller if cancellation is permitted for any delay in delivery, however short, is likely to be much greater than the damage suffered by the buyer. It must be clear, therefore, that the treatment of time stipulations, even in mercantile contracts, admits of no simple generalization.⁸⁰

However, it would be wrong to conclude, in the context of time stipulations, that our recommendation that a system of *a priori* classification should not be applied, will leave the parties adrift in a sea of uncertainty. First, in the great majority of cases, the parties should have no

⁷⁷Halsbury's *Laws of England*, (3rd ed., 1960), Vol. 34, para. 71, pp. 45-46.

⁷⁸Compare, *Williston on Sales* (Rev. ed., 1948), sec. 453a; and *Corbin on Contracts*, Vol. 3A, sec. 718, which provides as follows:

718. It can not truthfully be said that, in contracts for the sale of goods, or in 'contracts of merchants', time is always of the essence. Here, as elsewhere, the parties can make it so by the use of express words; but, if they do not, then it depends on circumstances. 'Merchants' make all sorts of contracts for all sorts of purposes. 'Goods' of many kinds are bought and sold for many purposes. If delivery or payment is promised at a specified date, a later delivery or payment is a breach of duty; but whether the lateness is such as to justify the other party in not paying or delivering depends on circumstances.

⁷⁹Compare, Corbin, footnote 78 *supra*, sec. 719, and *Paton & Sons v. Payne & Co.* (1897), 35 Sc. L.R. 112 (H.L.).

⁸⁰This is recognized in the cautious wording of the *Restatement of the Law of Contracts*, sec. 276(b), which provides as follows:

In determining the materiality of delay in performance, the following rules are applicable:

(b) In mercantile contracts performance at the time agreed upon is important, and if the delay of one party is considerable having reference to the nature of the transaction and the seriousness of the consequences, and is not justified by the conduct of the other party, the duty of the latter is discharged.

difficulty in ascertaining whether a court is likely to treat a particular breach as to time as amounting to a substantial or a minor breach. Secondly, the parties will continue to be free to make time of the essence, or to adopt such other provisions with respect to the characterization of terms or the remedies for breach as they see fit, so long as they do not violate the basic norms of conscientability and good faith discussed later in this Report⁸¹ and recommended for adoption in the revised Act. Thirdly, as will be discussed more fully hereafter,⁸² we also recommend the adoption of provisions entitling an aggrieved buyer or seller to treat a delay in making or taking delivery, or in payment, as amounting to a substantial breach where the party in breach has failed to perform within a reasonable time after being requested to do so.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The revised Act should adopt the definition of express warranty contained in section 12 of the American *Uniform Sales Act*, subject to the following modifications and observations:
 - (a) The definition should apply to representations or promises made by buyers as well as sellers, and should include representations or promises made by "the seller, manufacturer or distributor of the goods", whether or not there is privity of contract between the representor and representee.
 - (b) The definition should apply to representations or promises relating to goods that are the subject of a contract of sale, and that are made before, or at the time of, the contract of sale.
 - (c) There should be no general presumption that a seller is deemed to adopt the representations or promises made by a third party in relation to the goods in non-consumer sales.
 - (d) The natural tendency of such representations or promises must be to induce the buyer, or buyers generally if the representation or promise is made to the public, to purchase the goods, but no proof of actual reliance should be required where the representation or promise is made to the public.
 - (e) Negligence should not be a material factor in determining whether a representation amounts to a warranty; nor should language of commendation be excluded from the definition of express warranty if it otherwise satisfies the reliance requirement.
 - (f) No distinction should be made between commercial and private sales in respect of the measure of damages for breach of a non-promissory warranty, but this recommendation is without prejudice to a review at some later date of the damage rules applicable to private sales of goods.

⁸¹*Infra*, ch. 7.

⁸²*Infra*, chapters 16, 17.

- (g) The Commission makes no recommendation at the present time with respect to any extension of the definition of express warranty beyond the area of sale of goods.
- 2. The equitable remedies for misrepresentation inducing the making of a contract of sale should not be abolished. Nor should the representee be precluded from pursuing any other non-contractual causes of action arising out of the representation. Accordingly, the revised Act should provide that the rights of action of an aggrieved party, arising otherwise than in contract, are not affected by the existence of a contract of sale, except insofar as the contract itself so provides.
- 3. In an action for fraudulent misrepresentation inducing the formation of a contract of sale, the plaintiff should be entitled to invoke his remedies under the revised Act for breach of warranty, as well as his non-contractual remedies. The plaintiff should not be put to his election.
- 4. To resolve ambiguities in the use of the term "rescission", the revised Act should make it clear, following the second sentence of UCC 2-721, that rescission or a claim for rescission of the contract of sale or rejection or return of the goods, shall not bar or of itself preclude a claim for damages or other remedy.
- 5. The revised Act should eliminate the distinction between warranty and condition and, where appropriate, substitute the single term "warranty".
- 6. In order to determine the remedies available to an aggrieved buyer or seller and when he may cancel the contract because of breach by the other, the revised Act should adopt a unitary concept of substantial breach in place of the existing classification of warranties and conditions.

CHAPTER 7

FREEDOM OF CONTRACT AND MINIMUM BEHAVIOURAL STANDARDS: THE DOCTRINES OF UNCONSCIONABILITY AND GOOD FAITH IN PERFORMANCE AND ENFORCEMENT

A. THE DOCTRINE OF UNCONSCIONABILITY

1. THE GENERAL ISSUE

The right to bargain to one's best advantage is inherent in the very concept of contract, and is recognized in section 53 of the Ontario Sale of Goods Act. All civilized legal systems, however, have long recognized the need to balance freedom of contract with the need to protect the weaker party against over-reaching by the stronger party.¹ The challenge that confronted the draftsmen of Article 2 of the *Uniform Commercial Code* was whether their constituents were ready to confer a generalized power upon the courts to grant relief from unconscionable bargains, such as is now contained in the celebrated section 2-302. Predictably, their earliest efforts provoked great controversy. The provision was substantially altered in later drafts,² and the current version of section 2-302 emerged in the Official Text adopted by the sponsoring organizations in 1952. It reads as follows:

- (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
- (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

The Code's doctrine of unconscionability and its subsequent handling by the courts have attracted an immense amount of learned comment.³ However, the initial excitement generated by the appearance of this radical departure from accepted contract learning has subsided. Subsequent legislative and judicial developments have fully vindicated the judgment of two

¹For a general discussion of the doctrine of unconscionability, see Trebilcock, "Fair Exchange of Values in Sales Transactions: the Doctrine of Unconscionability", Research Paper No. III.4; and Waddams, "Unconscionability in Contracts" (1976), 39 Mod. L.R. 369.

²See, Trebilcock, *supra*, pp. 30-32.

³See, among others: Note, "The Doctrine of Unconscionability" (1967), 19 Maine L. Rev. 81; Harrington, "Unconscionability under the Uniform Commercial Code" (1968), 10 South Texas L. J. 203; Spanogle, "Analyzing Unconscionability Problems" (1969), 117 U. Pa. L. Rev. 931; Younger, "Judge's View of Unconscionability" (1973), 5 U.C.C. L.J. 348; Duesenberg, "Practitioner's View of Contract Unconscionability" (1976), 8 U.C.C. L.J. 237.

American authors⁴ that the section embodied an idea whose time had arrived. We share this view and, subject to the more detailed comments offered below, recommend the adoption of an unconscionability provision in the revised Ontario Act.

It was a firmly held dogma of late 19th century English contract law, that the law should not be a mender of improvident bargains freely entered into, and that the overriding duty of the courts was to respect the autonomy of the parties' will.⁵ This abstentionist view of the judicial role mirrored the prevailing influence of the economic doctrine of *laissez-faire*. This doctrine held that free choice in the marketplace and the self-interest of individuals would ensure that the proper contractual balance would be struck and abuses avoided.

This idealized view of the operations of the marketplace never fully corresponded with practice. A comparative glance at the experience of other legal systems,⁶ not to mention the long history of equity's intervention with respect to mortgage loans, penalties and forfeitures, might have mellowed some of the Victorian optimism. The experience following the repeal of the usury acts, and the necessity to re-introduce money lending controls to curb abuses, must also have given pause for reflection. The utilitarian concept became increasingly anachronistic as standard form contracts replaced individually negotiated terms, and powerful corporations, with the ability and willingness to impose unilateral terms, displaced the small entrepreneur and skilled artisan of an earlier day.

Neither the courts nor the legislatures were oblivious to the changing character of the marketplace. Consumer protection legislation in the credit and sales areas emerged in Ontario even before the turn of the century, and has been sustained since at an increasing tempo. For a long time, however, judicial reaction to unconscionable bargaining behaviour took a more covert form. Unfair clauses were rarely policed explicitly in the name of a minimum behavioural baseline; but the same ends were often reached by a "strict" construction of agreements and a willingness to find evidence of fraud and other forms of impeachable conduct. Examples of this process of judicial emasculation of traditional contract doctrines in the field of disclaimer clauses are legion, and were discussed in the Commission's *Report on Consumer Warranties*.⁷ In recent years, the Anglo-Canadian courts have begun to discard these more oblique means for a more explicit policing role. The equitable doctrine of constructive fraud has been infused with a new lease on life to restrain the exploitation of a manifestly weaker

⁴White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), p. 115.

⁵See, for example, *Printing and Numerical Registering Co. v. Sampson* (1875), L.R. 19 Eq. 462, *per Jessel, M.R.*, at p. 465, cited in Cheshire and Fifoot, *The Law of Contract* (7th ed., 1969), p. 21.

⁶Notably the provisions in sections 138 and 242 of the German Civil Code.

⁷Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), pp. 50-53.

party.⁸ Still more striking are some of the judicial utterances in such recent decisions as *Clifford Davis Management Ltd. v. WEA Records Ltd.*,⁹ *Lloyds Bank Ltd. v. Bundy*,¹⁰ and *Schroeder Music Publishing Co. Ltd. v. Macaulay*,¹¹ favouring a broad doctrine of unconscionability. Whether these cases involve a basic reversal of the earlier abstentionist philosophy remains to be seen. If they do, and assuming the Canadian courts follow suit,¹² they will only be mirroring the celebrated shift in American judicial philosophy represented by the New Jersey Supreme Court's decision in 1960 in *Henningesen v. Bloomfield Motors, Inc.*¹³

Further vindication for the Code's philosophy will be found in the recent adoption in Ontario of *The Business Practices Act, 1974*¹⁴ and the emergence of parallel legislation in Alberta, British Columbia and other provinces.¹⁵ In all of these, as in the earlier Unconscionable Transactions Relief statutes,¹⁶ unconscionable agreements are subjected to a regime of judicial or administrative surveillance, or both. An equally important source of precedent is provided by section 4 of the U.K. *Supply of Goods (Implied Terms) Act 1973*,¹⁷ now superseded in this respect by the *Unfair Contract Terms Act 1977*.¹⁸ These precedents are particularly significant because, unlike the Business Practices legislation, their provisions are not restricted to consumer sales. The same is true of the *Uniform Land Trans-*

⁸Trebilcock, footnote 1, *supra*, pp. 22 *et seq.* Some representative Canadian cases are: *Morrison v. Coast Finance Ltd.* (1965), 55 D.L.R. (2d) 710 (B.C.C.A.); *Knupp v. Bell* (1966), 58 D.L.R. (2d) 466 (Sask. Q.B.), aff'd 67 D.L.R. (2d) 256 (Sask. C.A.); *Marshall v. Canada Permanent Trust Co.* (1968), 69 D.L.R. (2d) 260 (Alta. S.C.); *Straiton v. Straiton* (1972), 30 D.L.R. (3d) 102 (B.C. S.C.); *Paris v. Machnik* (1973), 32 D.L.R. (3d) 723 (N.S. S.C.); *Black v. Wilcox* (1976), 12 O.R. (2d) 759 (C.A.). See also the Comment by Bradley Crawford in (1966), 44 Can. Bar Rev. 142.

⁹[1975] 1 W.L.R. 61, [1975] 1 All E.R. 237 (C.A.).

¹⁰[1975] Q.B. 326, [1974] 3 All E.R. 757 (C.A.), followed in *McKenzie v. Bank of Montreal* (1975), 7 O.R. (2d) 521, 55 D.L.R. (3d) 641 (Ont. H.C.J.), aff'd (1976) 12 O.R. 719 (C.A.), and distinguished on the facts in *Royal Bank of Canada v. Girgulis*, [1977] 6 W.W.R. 439 (Sask. Q.B.).

¹¹[1974] 3 All E.R. 616 (H.L.), aff'g [1974] 1 All E.R. 171.

¹²See, footnote 10 *supra*. And see, also, *Tilden Rent-A-Car Co. v. Clendenning* (1978), 18 O.R. (2d) 601 (C.A.).

¹³(1960), 161 A. 2d 69. In this case, which was decided on common law principles, the Court struck down a clause in a standard form contract that limited the liability of the manufacturer and seller of a motor vehicle as being contrary to public policy.

¹⁴S.O. 1974, c. 131.

¹⁵See, for example, *The Unfair Trade Practices Act*, S.A. 1975, c. 33; and the *Trade Practices Act*, S.B.C. 1974, c. 96 as am.

¹⁶For Ontario, see R.S.O. 1970, c. 472. Most of the other common law provinces have adopted almost identical legislation.

¹⁷1973, c. 13 (U.K.).

¹⁸1977, c. 50, s. 6 (U.K.). See, also, Thompson, *Unfair Contract Terms Act 1977*.

*actions Act*¹⁹ which, in section 1-311, has adopted an enlarged version of UCC 2-302.²⁰

In the light of these developments there seems little profit in pursuing further the merits of an unconscionability doctrine: the doctrine is rapidly becoming, if indeed it has not already become, a thoroughly respectable landmark in the modern law of sales.²¹ It will be more rewarding to consider a number of important subsidiary questions, which need to be answered once the decision of principle has been taken.

2. SPECIFIC QUESTIONS

(a) SHOULD THE DOCTRINE BE CONFINED TO CONSUMER SALES?

It may be thought that, since Ontario has already enacted legislation to protect consumers against unconscionable bargains, there is no need for an additional unconscionability provision in the revised Sale of Goods Act. In our opinion, this conclusion is not warranted. It is true that the majority of abuses occur in the consumer field, but it is not correct to assume that they occur *only* in this area. The rich Anglo-Canadian jurisprudence shows that small or inexperienced entrepreneurs can be hurt just as badly by one-sided and harsh bargains as the average consumer.²² The Code's draftsmen

¹⁹See, *supra*, ch. 2, text to footnote 109.

²⁰Section 1-311 provides:

- (a) The court, upon finding as a matter of law that a contract or contract clause was unconscionable at the time the contract was made, may refuse to enforce the contract, enforce the remainder of the contract without the unconscionable clause, or limit the application of any unconscionable clause in order to avoid an unconscionable result.
- (b) Whenever it is claimed, or appears to the court, that a contract or any contract clause is or may be unconscionable, the parties, in order to aid the court in making the determination, shall be afforded a reasonable opportunity to present evidence as to:
 - (1) the commercial setting of the negotiations;
 - (2) whether a party has knowingly taken advantage of the inability of the other party reasonably to protect his interests by reason of physical or mental infirmity, illiteracy, or inability to understand the language of the agreement, or similar factors;
 - (3) the effect and purpose of the contract or clause; and
 - (4) if a sale, any gross disparity, at the time of contracting, between the amount charged for the real estate and the value of the real estate measured by the price at which similar real estate was readily obtainable in similar transactions, but a disparity between the contract price and the value of the real estate measured by the price at which similar real estate was readily obtainable in similar transactions does not, of itself, render the contract unconscionable.

²¹See, Trebilcock, footnote 1 *supra*, at p. 41.

²²Both the *Clifford Davis* and *Macaulay* decisions, footnotes 9 and 11 *supra*, involved non-consumer contracts as do most of the recent Canadian cases on the validity of liquidated damages clauses in equipment leases. See, for example, *C.A.C. v. Regent Park Butcher Shop* (1969), 3 D.L.R. (3d) 304 (Man. C.A.). The now well established *Federal Discount* doctrine also began its career with a contract that technically was of a non-consumer character: see, *Federal Discount Corp. v. St. Pierre*, [1962] O.R. 310 (C.A.).

obviously shared this sentiment. Further, as has been noted, the attempt to confine the doctrine to consumer transactions has also been rejected in the recently adopted U.K. *Unfair Contract Terms Act 1977*.²³

(b) SHOULD THE DOCTRINE BE RESTRICTED TO CASES OF PROCEDURAL UNCONSCIONABILITY?

The distinction between substantive and procedural unconscionability is one that has been heavily emphasized by some American scholars. Professor Leff,²⁴ in particular, has argued that the court's power to interfere should be restricted to cases of procedural unconscionability. According to this line of reasoning, the mere existence of a harsh clause, or of a bargain that is improvident in its entirety, should not attract the operation of the doctrine unless the transaction is accompanied by elements of procedural unconscionability; that is, some form of exploitation of the weakness, ignorance or gullibility of the other party. This approach finds some support in the Comments to section 2-302, although not in the text of the section, and in the case law under U.K. money-lenders legislation and the corresponding provisions in the Unconscionable Transactions Relief statutes of Canadian jurisdictions. On the other hand, it has been rejected in the *Uniform Land Transactions Act*.²⁵

While not questioning the importance of procedural factors, the distinction between substantive and procedural is, in our view, too rigid. We do not, therefore, recommend its adoption. What is "procedural" and what is "substantive" will frequently result in a sterile debate. These are not terms of art. Let us suppose an exculpatory clause is clearly flagged so that the buyer cannot avoid noticing its presence; should this preclude a court from finding the clause unconscionable if the product is the only one of its kind or if other manufacturers use an identical provision? What is important, it seems to us, is that the tribunal should be able to investigate all the circumstances of a transaction without being restricted in the scope of its inquiry. We are fortified in our conclusion by the fact that none of the criteria of unconscionability listed in recent Canadian, American and U.K. legislation are restricted to examples of what might be considered to be procedural unconscionability.

(c) SHOULD THERE BE A LIST OF CRITERIA TO GUIDE THE COURT IN ITS DETERMINATION OF THE ISSUE?

A recurring complaint about the unconscionability concept as enshrined in section 2-302 of the Code, has been that it is too abstract, too elusive, and too subjective, and that it provides the court with little assistance with respect to the factors that should be taken into consideration in making a finding one way or the other. This weakness is inherent in many

²³Supra, footnote 18. The Act implements the recommendations of the English and Scottish Law Commissions in their *Second Report on Exemption Clauses* (August, 1975), (Law Com. No. 69, Scot. Law Com. No. 39).

²⁴"Unconscionability and the Code — the Emperor's New Clause" (1967), 115 U. Pa. L. Rev. 485; Trebilcock, footnote 1 *supra*, pp. 32-33. Compare, White & Summers, footnote 4 *supra*, pp. 128-29.

²⁵Section 1-311, Comment 4.

value concepts, and is one that can never be totally removed without destroying the utility of the concept in question. Nevertheless, we consider that a list of non-exhaustive criteria would be useful, and should be incorporated in the revised Act.

There are numerous precedents that could be culled in order to make up a suitable list. The Ontario Business Practices Act, 1974,²⁶ for example, invites the court to consider the following factors in determining whether a consumer representation is unconscionable:

Section 2(b)

- ...
 - (i) that the consumer is not reasonably able to protect his interests because of his physical infirmity, ignorance, illiteracy, inability to understand the language of an agreement or similar factors,
 - (ii) that the price grossly exceeds the price at which similar goods or services are readily available to like consumers,
 - (iii) that the consumer is unable to receive a substantial benefit from the subject-matter of the consumer representation,
 - (iv) that there is no reasonable probability of payment of the obligation in full by the consumer,
 - (v) that the proposed transaction is excessively one-sided in favour of someone other than the consumer,
 - (vi) that the terms or conditions of the proposed transaction are so adverse to the consumer as to be inequitable,
 - (vii) that he is making a misleading statement of opinion on which the consumer is likely to rely to his detriment,
 - (viii) that he is subjecting the consumer to undue pressure to enter into the transaction.

The U.K. *Supply of Goods (Implied Terms) Act 1973* contained a shorter list, and one that was more specifically geared to non-consumer sale transactions. It enumerated the following matters:²⁷

Section 4

- ...
 - (a) the strength of the bargaining positions of the seller and buyer relative to each other, taking into account, among other things, the availability of suitable alternative products and sources of supply;
 - (b) whether the buyer received an inducement to agree to the term or in accepting it had an opportunity of buying the goods or suitable alternatives without it from any source of supply;

²⁶S.O. 1974, c. 131, s. 2(b).

²⁷1973, c. 13, s. 4 (U.K.) adding s. 55(4) to the *Sale of Goods Act, 1893*. Substantially the same list of criteria appears in the *Unfair Contract Terms Act 1977*, Schedule 2, replacing those in the 1973 Act.

- (c) whether the buyer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);
- (d) where the term exempts from all or any of the provisions of section 13, 14 or 15 of this Act if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;
- (e) whether the goods were manufactured, processed, or adapted to the special order of the buyer.

Our Draft Bill²⁸ contains a synthesized list of criteria based on these and other precedents. Since the provisions are reproduced later in this chapter it is not necessary to summarize them here.

(d) SHOULD THE COURT BE ABLE TO RAISE THE ISSUE OF UNCONSCIONABILITY OF ITS OWN ACCORD?

A literal reading of section 2-302(2) leaves the impression that the court can raise the issue of unconscionability on its own motion, although at least one court²⁹ has refused to give this rendering to the words "or appears to the court", as they appear in UCC 2-302(2). While the question is not free from difficulty, we have reached the conclusion that the court should be entitled to raise the issue of unconscionability of its own motion. We so recommend, and our Draft Bill contains a provision to this effect.³⁰

(e) WHAT TYPES OF RELIEF?

Open textured as it is in one respect, section 2-302 is very circumscribed in the types of relief a court may allow from an agreement or a clause that it finds unconscionable.³¹ It seems that the court is confined to three remedies: (a) the court may refuse to enforce the contract; (b) it may enforce the remainder of the contract without the unconscionable clause; or, (c) it may so limit the application of any unconscionable clause as to avoid any unconscionable result. In our opinion, these powers are too restrictive and may prevent the court from doing full justice. Particularly noteworthy is the court's inability to allow rescission of the agreement or, on one construction of alternative (c), to order repayment of part of the price where the court finds the price to be excessive. Both these powers are contained in section 4 of *The Business Practices Act* and similar legislation in other jurisdictions.³² By way of comparison, it may be noted that *The Unconscionable Transactions Relief Act*³³ allows the court to re-open

²⁸Section 5.2.

²⁹Asco Mining Co. v. Gross Contracting Co. (1965), 3 U.C.C. Rep. 293, cited in White & Summers, footnote 4 *supra*, p. 115, n. 14.

³⁰See, Draft Bill, s. 5.2(4).

³¹White & Summers, footnote 4 *supra*, pp. 131-32.

³²Indeed, section 4(1)(a) goes further and, on a literal reading, gives the consumer an absolute right to rescind.

³³R.S.O. 1970, c. 472, s. 2(d).

the transaction and "to set aside either wholly or in part or revise or alter any security given or agreement made in respect of the money lent". We recommend that, in addition to the remedies provided by UCC 2-302, similar powers be incorporated in the unconscionability provision of the revised Ontario Act, so as to enable the courts to do full justice as the circumstances may dictate.

Section 2-302 confers no power to award damages³⁴ and we do not recommend the addition of such a provision. It is true the power exists in *The Business Practices Act*, in section 4(1)(a) and (2), but that Act is concerned with false and misleading representations as well as other unfair practices. A power to award damages for intentional or negligent misrepresentations, which are actionable wrongs, is not necessarily appropriate in the case of an agreement which, although regarded as unfair, was not induced by misrepresentation and which, therefore, has traditionally attracted only equitable forms of relief. In view of the uncertain boundaries of the doctrine of unconscionability, especially in the non-consumer area, it would be unwise, in our view, to treat an unconscionable bargain as grounding an action in tort. Our recommendation would not, however, preclude a court from allowing damages where the impeached contract, as well as being unconscionable, was accompanied by other conduct constituting a recognized form of tort, such as fraud or duress.

(f) DISCLAIMER OF UNCONSCIONABILITY DEFENCES

UCC 2-302 does not preclude the parties from excluding its terms; nor does UCC 1-103(3), which deals generally with excludable and non-excludable provisions of the Code. Given its pre-eminent character, it may safely be assumed that UCC 2-302 was not intended to be excludable. Nevertheless, we think it better not to leave the question in doubt, however tenuous the doubt may be. Accordingly, we recommend the incorporation in the revised Act of a specific provision to the effect that the powers conferred under the unconscionability provision shall apply notwithstanding any agreement or waiver to the contrary.³⁵

3. LEGISLATIVE PROPOSAL

Having canvassed the various facets of a legislative doctrine of unconscionability, it may be convenient now to reproduce our recommended version of UCC 2-302:³⁶

- 5.2.-(1) If, with respect to a contract of sale, the court finds the contract or a part thereof to have been unconscionable at the time it was made, the court may
 - (a) refuse to enforce the contract or rescind it on such terms as may be just;

³⁴Compare, *Pearson v. National Budgeting Systems, Inc.* (1969), 297 N.Y.S. 2d 59 (Sup. Ct., App. Div.).

³⁵See, Draft Bill, s. 5.2(5); and compare, *The Business Practices Act*, S.O. 1974, c. 131, s. 4(8).

³⁶See, Draft Bill, s. 5.2.

- (b) enforce the remainder of the contract without the unconscionable part; or
 - (c) so limit the application of any unconscionable part or revise or alter the contract as to avoid any unconscionable result.
- (2) In determining whether a contract of sale or a part thereof is unconscionable, or whether the operation of an agreement is unconscionable under section 5.7(3), the court may consider, among other factors:
- (a) the degree to which one party has taken advantage of the inability of the other party reasonably to protect his interests because of his physical or mental infirmity, illiteracy, inability to understand the language of an agreement, lack of education, lack of business knowledge or experience, financial distress, or similar factors;
 - (b) gross disparity between the price of the goods and the price at which similar goods could be readily sold or purchased by parties in similar circumstances;
 - (c) knowledge by one party, when entering into the contract, that the other party will be substantially deprived of the benefit or benefits reasonably anticipated by that other party under the transaction;
 - (d) the degree to which the contract requires a party to waive rights to which he would otherwise be entitled;
 - (e) the degree to which the natural effect of the transaction, or any party's conduct prior to, or at the time of, the transaction, is to cause or aid in causing another party to misunderstand the true nature of the transaction and of his rights and duties thereunder;
 - (f) the bargaining strength of the seller and the buyer relative to each other, taking into account the availability of reasonable alternative sources of supply or demand;
 - (g) whether the party seeking relief knew or ought reasonably to have known of the existence and extent of the term or terms alleged to be unconscionable;
 - (h) in the case of a provision that purports to exclude or limit a liability that would otherwise attach to the party seeking to rely on it, which party is better able to safeguard himself against loss or damages; and
 - (i) the general commercial setting, purpose and effect of the contract.
- (3) The court shall not make a finding of unconscionability based solely upon

- (a) the factor mentioned in clause *d* of subsection 2; or
 - (b) the fact that the contract varies or excludes a provision of this Act or other legal rights.
- (4) The court may raise the issue of unconscionability of its own motion.
- (5) The powers conferred by this section apply notwithstanding any agreement or waiver to the contrary.

Subsection (1) maps out the scope of the court's power of intervention and the types of relief it may award. It will be noted that, as in the case of the Code, it covers *any* aspect of the contract and applies equally to seller and buyer. The court, however, is not entitled to exercise hindsight, and any finding of unconscionability must relate to the contract "at the time it was made".³⁷ Subsection (2) sets forth the criteria of unconscionability that the court "may", but is not required to, consider. These criteria are based on earlier precedents and do not call for further comment. Subsection (3) is new, and is designed to repudiate explicitly any suggestion that a waiver of a party's rights, whether arising at common law or under the Act, is, of itself, evidence of unconscionability. We have thought it desirable to add this provision in order to protect the integrity of the general contracting out provision in the Draft Bill,³⁸ and to counteract some of the more extreme judicial reactions to disclaimer clauses where there is no other evidence of unfairness in the bargain. We return to this problem in a later chapter.³⁹ The rationale of subsections (4) and (5) have been explained previously.

It will be noted that our draft proposal contains no reference to the position of third parties claiming rights under the contract whose position may be adversely affected by the defence of unconscionability. Our reasons are similar to those that were advanced⁴⁰ by us in connection with our earlier recommendation that abolition of the parol evidence rule should not be accompanied by special provisions dealing with the position of third parties claiming rights under the writing.

4. A CAUTIONARY NOTE

Section 2-302 is not a universal panacea to all the difficulties that afflict the modern marketplace; nor was it intended to undermine the binding character of freely concluded bargains. As an American court put it eloquently,⁴¹ "the doctrine of unconscionability is not a charter of economic anarchy . . . a promisor can be relieved of his obligation . . . only when the transaction affronts the sense of decency without which business is mere predation and the administration of justice an exercise in book-keeping". UCC 2-302 is designed, rather, to make explicit a power that

³⁷A contrary view was entertained by the English Law Commission (but not the Scottish Law Commission), footnote 23 *supra*, paras. 169-182.

³⁸See, s. 5.16.

³⁹*Infra*, ch. 9, sec. 7.

⁴⁰*Supra*, ch. 5, sec. 7.

⁴¹See, *Gimbel Bros., Inc. v. Swift* (1970), 307 N.Y.S. 2d 952 (N.Y. City Civil Ct.), 954.

the courts have long exercised covertly and to put it on a more rational basis. We appreciate that businessmen may not welcome this additional layer of uncertainty. We should emphasize, however, that there has been no disposition on the part of American courts to use section 2-302 as a general dispensing agent for contractual obligations,⁴² and we are confident that the power would be exercised at least as responsibly by Ontario courts.

B. GOOD FAITH IN PERFORMANCE AND ENFORCEMENT

1. INTRODUCTION

The doctrine of good faith is a logical complement to the doctrine of unconscionability.⁴³ The distinction between the two may be stated in this way: the doctrine of unconscionability is concerned with fairness in the terms of a bargain; the doctrine of good faith, on the other hand, focuses on decent behaviour in the exercise of rights or duties imposed under the terms of the agreement or by the governing Act. Both concepts derive their source from a common ethical sense and from the need to protect a contracting party from an abusive exercise of power. Like unconscionability, the flexibility inherent in the concept of good faith is also its weakness: its imprecision makes for uncertainty and, in the eyes of some critics, subordinates the interests of the individual to the whims of the court.

Good faith is not, of course, a novel concept. Since Roman times, it has had a continuous history, and occupies a secure place in the civilian systems of law.⁴⁴ In the common law, good faith is best known in connection with the concept of the purchaser for value; but this is only one facet of its role. A much wider range of functions is reserved for good faith in regulating the performance or enforcement of contractual rights and duties. This is true where the contract or the governing Act confers a wide latitude of action, or inaction: for example, in the case of open price contracts;⁴⁵ output, requirements and exclusive dealing contracts;⁴⁶ or, contracts containing the power to terminate at will.⁴⁷ It also applies to more specifically oriented situations, such as the power to reject for non-conformity,⁴⁸ or the right of repossession and resale in the case of secured sales where the buyer is in default.⁴⁹ As has been shown elsewhere,⁵⁰ behavioural guidelines have been adopted by the Anglo-Canadian courts in some of these cases, but not in others. Sometimes the case law is unsettled. Often the decision is based upon an implied promise or upon canons of construction deemed appropriate to give the contract a "reasonable" meaning. It cannot therefore be said that good faith is already an integral part of our sales law.

⁴²Compare, White & Summers, footnote 4 *supra*, p. 114, and the cases cited in n. 11.

⁴³For a general discussion of the doctrine of good faith in sales transactions, see Trebilcock, "Good Faith in Sales Transactions", Research Paper No. II.3.

⁴⁴*Ibid.*, pp. 4 *et seq.*; Powell, "Good Faith in Contracts" (1956), 9 Current Legal Problems 16.

⁴⁵Compare, UCC 2-305.

⁴⁶Compare, UCC 2-306.

⁴⁷Compare, UCC 2-309(2).

⁴⁸UCC 2-601 *et seq.*

⁴⁹*Uniform Commercial Code*, Article 9, Part V.

⁵⁰Trebilcock, footnote 43 *supra*, pp. 4 *et seq.*

Indeed, the opposite has often been asserted, or is generally assumed.⁵¹ The question is whether it should be, and if so, how good faith should be defined for this purpose.

2. CODE PROVISIONS⁵²

One of the many virtues of the Code is that its draftsmen clearly perceived these problems of integration and definition and attempted to supply some answers. The weakness of the Code provisions is that they fail to provide a strong and consistent framework, a result that may be ascribed to opposition from some sections of the Bar and, possibly, to disagreement among the sponsoring organizations with respect to the proper scope of the concept of good faith.

The three key provisions of the Code are sections 1-203, 1-209(19), and 2-103(1)(b). Section 1-203 enunciates the seemingly strong rule that "every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement". The critical factor, it will be noted, is the meaning of good faith. This term is defined in section 1-201(19) as meaning "honesty in fact in the conduct or transaction concerned". The definition was obviously based on prior statutes⁵³ and case law dealing with the defence of a purchaser for value or holder in due course. As such, the definition bears little relevance to the types of problem that normally arise in performance or enforcement issues: the issue in the latter type of context is not whether the party acted honestly, but whether he acted reasonably or fairly, which is quite a different matter. As a result, as a learned commentator has argued cogently,⁵⁴ section 1-203 has been "so enfeebled that it could scarcely qualify . . . as an 'overriding' or 'super-eminent' principle".

Good faith was not always so narrowly defined. In the 1949 version of the Code the following sentence appeared after the present definition in UCC 1-201(19):⁵⁵

Good faith includes good faith towards all prior parties and observance by a person of the reasonable commercial standards of any business or trade in which he is engaged.

This sentence was dropped, apparently because of opposition from the Section on Corporation, Banking and Business Law of the American Bar Association and others.⁵⁶ The Section gave three reasons for its opposition: (1) that to the average lawyer or laymen good faith principally signified "honesty"; (2) that the reference to reasonable commercial standards carried with it the implication of usages, customs or practices, and it was

⁵¹Powell, footnote 44 *supra*, at p. 25; Burrows, "Contractual Co-operation and the Implied Term" (1968), 31 Mod. L. Rev. 390, especially at p. 402.

⁵²See, generally, Farnsworth, "Good Faith Performance and Commercial Reasonableness under the Uniform Commercial Code" (1963), 30 U. Chi. L. Rev. 666; Summers, "'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code" (1968), 54 Va. L. Rev. 195.

⁵³See, UCC 1-201, Official Comment No. 19; and compare, the *Bills of Exchange Act*, R.S.C. 1970, c. B-5, s. 3 as am.

⁵⁴Farnsworth, footnote 52 *supra*, at p. 674.

⁵⁵See, Summers, footnote 52 *supra*, at p. 207.

⁵⁶*Ibid.*, at pp. 208-09.

often difficult to establish what these norms were for a particular trade or business; and, (3) that "reasonable commercial standards" could mean usages, customs or practices existing at a particular time and could, therefore, lead to freezing of the desirable flexibility inherent in these standards. Despite these criticisms, the Section was not completely opposed to some reference to "commercial decency", or something akin to this concept. The Section suggested the following definition:

'Good faith' means honesty in fact in the conduct or transaction concerned in the absence of trickery, deceit or improper purpose.

This suggestion was not adopted.

For reasons not revealed in the Code, the Code's sponsors decided upon a separate and higher standard of good faith for merchants involved in sales transactions. UCC 2-103(1)(b) provides that:

(1) *In this Article* unless the context otherwise requires:

...

(b) 'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade. (Emphasis added.)

It will be observed that the definition is subject to a number of important restrictions. First, it applies only where Article 2 itself imposes a duty of good faith. Only 13 of the 104 sections of Article 2 impose an explicit good faith requirement. Secondly, the definition is confined to merchants. Although, the term "merchant" is more widely defined⁵⁷ in Article 2 than in common usage, the statutory definition will still, if faithfully applied, exclude a large range of buyers and sellers. Thirdly, the definition presupposes standards of fair dealing in the trade. There may be none.

In the light of the combined obstacles presented by UCC 1-201(19), 1-203, and 2-103(1)(b), one American commentator has concluded⁵⁸ that the most promising source of the application of good faith standards may be through the invocation of general principles of law and equity, sanctioned by UCC 1-103.⁵⁹ The Code case law,⁶⁰ while not overabundant on this point, supports this suggestion, and also indicates a judicial tendency to blur the distinction between UCC 1-203 and 2-103, and to apply the higher standard of good faith introduced in UCC 2-103 to other Articles of the Code, notably Article 9. In any event, it is clear that UCC 1-203 provides more form than substance, and that UCC 2-103, while much stronger, is substantially restricted in scope.

⁵⁷See, UCC 2-104(1).

⁵⁸Summers, footnote 52 *supra*, at p. 197.

⁵⁹UCC 1-103 provides as follows:

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

⁶⁰For example, *In re Jackson* (1971), 9 U.C.C. Rep. 1152; *In re Johnson* (1973), 13 U.C.C. Rep. 953; *Urdang v. Muse* (1971), 8 U.C.C. Rep. 1220.

3. SECOND RESTATEMENT ON CONTRACTS

It would appear that the current members of the American Law Institute do not share the hesitations shown by the Code's sponsors. Section 231 of the Tentative Draft of the *Second Restatement on Contracts*⁶¹ provides simply and elegantly:

Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.

“Good faith” is not defined, and it is not clear whether the draftsmen meant to confine the concept to honesty in fact, leaving “fair dealing” to emphasize the additional requirements of decency and reasonableness in the exercise and discharge of contractual rights and obligations. It will be noted, too, that no distinction is drawn between merchants and non-merchants, or between different types of contract. It seems fair to conclude that the *Restatement* has decided to reinstate good faith as an “overriding” and “super-eminent” principle of contract law. The rationale supplied by the *Restatement*⁶² for the adoption of the higher good faith standard is that “good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving ‘bad faith’ because they violate community standards of decency, fairness or reasonableness”. The comments to section 231 supply many examples of types of conduct recognized in judicial decisions as demonstrating bad faith in performance or enforcement of contractual rights. It is obvious that the reporters of the *Restatement* thought that they were sufficient in scope and number to justify the broad principle enshrined in section 231.

To complete the narrative of post-Code developments, it may be useful to note that section 1-301 of the *Uniform Land Transactions Act* has also adopted a good faith requirement in the performance or enforcement of a contract or duty governed by the Act. “Good faith” was defined in the version of the Act originally adopted in 1975 as “honesty in fact and the observance of reasonable standards of fair dealing in the conduct or transaction involved”.⁶³ The accompanying Comment explained that the definition in UCC 2-103 was adopted in preference to the UCC 1-201 definition. The revised *Uniform Land Transactions Act* version omits any definition of good faith.

4. CONCLUSIONS

Whatever the failings of the Code provisions, the Commission agrees that good faith should be enshrined in the revised Ontario Act as a minimal behavioural baseline in the exercise of contractual and statutory rights and obligations. We are further of the opinion that the obligation

⁶¹While section 231, like the earlier sections, is still in tentative form, “it is, however, fair to say that major changes in these formulations are unlikely, given the consideration they have already received”: Introduction to Tentative Drafts Nos. 1-7 (Rev. & ed., 1973), p. viii.

⁶²*Restatement of the Law, Contracts 2d*, Section 231, Comment a.

⁶³See, s. 1-201(8).

of good faith should not be confined to merchants or any particular group of buyers and sellers. We are also agreed that the basic standard should be higher than honesty in fact, and that it should encompass the requirement of reasonableness and fair dealing. In our opinion, it would be anomalous to recognize the more substantial intervention in the contract making process represented by the doctrine of unconscionability, and yet to refuse to recognize a general obligation of good faith in the performance and enforcement of a contract that goes beyond honesty in fact. Nor are we persuaded that our proposals would leave too much to the discretion of the court. Our reaction is, rather, that such a doctrine of fair dealing accords best with the parties' own presumed intention of the meaning of their contract or, where the exercise of a statutory power is involved, the intention of the legislature.

In the light of these conclusions we recommend adoption of the following provisions in the revised Act:⁶⁴

- (1) Every right and duty that is created by a contract of sale or by this Act imposes an obligation of good faith in its enforcement or performance whether or not it is expressly so stated.
- (2) 'good faith' means honesty in fact and the observance of reasonable standards of fair dealing.

In our opinion, a definition of good faith is essential. We recognize the force of the argument⁶⁵ that good faith has no invariant meaning but takes its colour from the surrounding circumstances of individual cases. Nevertheless, given the absence of a consistent body of Anglo-Canadian case law, some guidance to the courts is necessary if a new period of uncertainty is to be avoided. The proposed definition of good faith is sufficiently flexible to allow ample scope for adjustment to the exigencies of individual cases. It will be observed that our definition of good faith is not restricted in its application to the parties to the contract. We have considered whether it should be so restricted, and whether a lower standard of conduct — honesty in fact — should be sufficient for third parties. We have decided against such a distinction on two grounds. The first is that it has not been drawn by the American courts in applying the comparable provisions in the Code.⁶⁶ The other ground is that there is, in our view, no sufficient reason why third parties claiming rights and powers under the revised Act should be in any different position in this respect than the parties to the contract of sale.

It will be noted that our recommended provision differs from UCC 1-203 in another respect. Our provision applies to the exercise of rights, contractual or statutory, as well as to the performance of obligations. It would seem obvious that the need for a good faith standard is as great in the former case as it is in the latter. Presumably, section 1-203 did not intend a different result, but it seems better to put the matter beyond doubt. It should be noted, too, that the good faith obligation applies to

⁶⁴See, Draft Bill, ss. 3.2, and 1.1(1)15.

⁶⁵Summers, footnote 52 *supra*, at pp. 196, 215-16.

⁶⁶See, for example, *Mattek v. Malofsky* (1969), 165 N.W. 2d 406 (Wis. Sup. Ct.).

all provisions of the revised Act; unlike Article 2 it is not confined to those sections where good faith is expressly stipulated. Nevertheless, in our Draft Bill we have thought it useful to retain the Code identifiers, and indeed to add to them to a modest extent, in order to help the courts and the parties identify readily those situations in which experience has shown the good faith component to be particularly important. It should be clearly understood, however, that we consider the good faith obligation to be all-encompassing; no adverse inferences should be drawn from the absence, in any particular provision, of any express stipulation.

An important question has been raised⁶⁷ concerning the binding character of good faith obligations. UCC 1-102(3) provides that the obligations of good faith, diligence, reasonableness and care prescribed by the Code "may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable". Notwithstanding this seemingly clear provision it has been argued⁶⁸ that the doctrine of good faith is little more than a canon of construction, in that it merely creates a statutory presumption that the parties have intended their rights and obligations under the contract to be performed in good faith. According to this view, good faith, like other presumptions, should be rebuttable by the express terms of the agreement. It would then be for the court, applying the doctrine of unconscionability or some other substantive law doctrine, to decide whether exclusion of the good faith requirement was reasonable or not. However, this reasoning appears to us to be based upon a misreading of UCC 1-203, and we do not support it. Whatever the pre-Code position may have been, it seems clear that section 1-203 was intended to create more than a statutory presumption. Like section 2-302 dealing with unconscionability, it was seen as a minimum rule of decent behaviour. It seems to us that it would be as inappropriate to permit the exclusion of the one as it would be to permit the exclusion of the other. For the reasons we have stated, it should not, in our opinion, be possible to disclaim the obligation of good faith by agreement. We consider, however, that, as in UCC 1-102(3), the parties should be able, by agreement, to determine the standards by which the performance of the obligation of good faith is to be measured, if such standards are not manifestly unreasonable. Accordingly, we recommend that the revised Act should contain a provision similar to UCC 1-102(3). Our Draft Bill so provides.⁶⁹

We recognize that the terms of the contract may affect the scope of the good faith obligation in a particular case. Suppose for example, that a requirements contract is silent about the possible range of fluctuations in the buyer's requirements. The contract would, in these circumstances, be interpreted in the light of the parties' past dealings, if any, and the provisions of UCC 2-306, which includes a good faith standard. The buyer would not be free to act capriciously. Let us suppose, however, that the contract expressly provides that the buyer is not required

⁶⁷See, Trebilcock, footnote 43 *supra*, pp. 76-77.

⁶⁸*Ibid.*

⁶⁹See, Draft Bill, s. 3.1(2).

to have minimum requirements, or that he is free to increase his requirements at any time up to 100 per cent of his average requirements during a given period. As long as the buyer is acting honestly, he should be entitled to invoke these provisions, even though he would not have had the same freedom had the contract been of the first type. To this extent, it is true to say that good faith is a matter of construction. This is not the same thing as saying that good faith itself may be excluded as a normative requirement.

5. GOOD FAITH IN BARGAINING

The research paper prepared for the Commission demonstrates⁷⁰ that good faith can play as important a role in preventing abuses in the negotiating stage of a contract as it plays in policing performance practices. The paper therefore recommends that the revised Act, or perhaps a Law of Contract Amendment Act, recognize this fact by explicitly extending the good faith requirement to the pre-contractual phase. While we are generally sympathetic to this suggestion, it appears to us, on at least two grounds, that action on the proposal should be deferred for the time being. First, the Anglo-Canadian case law is still fragmentary, and no clear principle emerges from the decided cases. It would be unwise, therefore, to press statutory reform before the full implications of the change are grasped. The second reason is that the kind of provision contemplated will depend very much on future reform of the law of consideration⁷¹ and on the adoption of a general principle of injurious reliance comparable to section 90 of the American *Second Restatement on Contracts*. If a provision similar to section 90 is adopted, the need for a separate rule to govern good faith in bargaining will be much diminished, although by no means totally eliminated.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The revised Act should contain a general provision empowering the court to refuse to enforce a contract, or a term thereof, on the ground of unconscionability. This provision should incorporate the following features:
 - (a) The provision should not be confined to consumer sales; nor should the court's powers be restricted to cases of procedural unconscionability.
 - (b) The provision should contain the following non-exhaustive list of criteria to assist the court in its determination of the issue of unconscionability:
 - (a) the degree to which one party has taken advantage of the inability of the other party reasonably to protect his interests because of his physical or mental infirmity, illiteracy, inability to understand the language of an

⁷⁰Supra, footnote 43, Part III.

⁷¹Compare, supra, ch. 5, sec. 4.

- agreement, lack of education, lack of business knowledge or experience, financial distress, or similar factors;
- (b) gross disparity between the price of the goods and the price at which similar goods could be readily sold or purchased by parties in similar circumstances;
 - (c) knowledge by one party, when entering into the contract, that the other party will be substantially deprived of the benefit or benefits reasonably anticipated by that other party under the transaction;
 - (d) the degree to which the contract requires a party to waive rights to which he would otherwise be entitled;
 - (e) the degree to which the natural effect of the transaction, or any party's conduct prior to, or at the time of, the transaction, is to cause or aid in causing another party to misunderstand the true nature of the transaction and of his rights and duties thereunder;
 - (f) the bargaining strength of the seller and the buyer relative to each other, taking into account the availability of reasonable alternative sources of supply or demand;
 - (g) whether the party seeking relief knew or ought reasonably to have known of the existence and extent of the term or terms alleged to be unconscionable;
 - (h) in the case of a provision that purports to exclude or limit a liability that would otherwise attach to the party seeking to rely on it, which party is better able to safeguard himself against loss or damages; and
 - (i) the general commercial setting, purpose and effect of the contract.
- (c) The provision should make it clear that a waiver of a party's rights, whether arising at common law or under the Act, is not, of itself, evidence of unconscionability.
- (d) The provision should state specifically that the powers conferred under the unconscionability section shall apply notwithstanding any agreement or waiver to the contrary.
2. The court should be able to raise the issue of unconscionability of its own motion.
 3. The court should be empowered to grant the following types of relief:
 - (a) to refuse to enforce the contract or rescind it on such terms as may be just;
 - (b) to enforce the remainder of the contract without the unconscionable part; or

- (c) to so limit the application of any unconscionable part or revise or alter the contract as to avoid any unconscionable result.
- 4. There should be no power to award damages where the court finds an agreement unconscionable. This recommendation should not, however, preclude a court from allowing damages where the impeached contract, as well as being unconscionable, was accompanied by other conduct constituting a recognized form of tort, such as fraud or duress.
- 5. The unconscionability provision should not be accompanied by special provisions dealing with the position of third parties claiming rights under a contract whose rights may be adversely affected by a defence of unconscionability.
- 6. Good faith, as a minimum behavioural baseline in the exercise of contractual and statutory rights and obligations, should be incorporated in the revised Ontario Act. The obligation of good faith should not be confined to merchants or to any particular group of buyers and sellers.
- 7. The basic standard of good faith should be higher than honesty in fact, and should encompass the requirement of reasonableness and fair dealing.
- 8. Specifically, the revised Act should contain the following provisions on good faith:
 - (1) Every right and duty that is created by a contract of sale or by this Act imposes an obligation of good faith in its enforcement or performance whether or not it is expressly so stated.
 - (2) 'good faith' means honesty in fact and the observance of reasonable standards of fair dealing.
- 9. The obligation of good faith should not be restricted to parties to the contract.
- 10. It should not be possible to disclaim the obligation of good faith by agreement, although, as in UCC 1-102(3), the parties should be able, by agreement, to determine the standards by which the performance of the obligation of good faith is to be measured, if such standards are not manifestly unreasonable.
- 11. No action should be taken at the present time to give statutory sanction to a principle of good faith in bargaining. This position should be reviewed in the light of any future changes in the Ontario law of consideration.

CHAPTER 8

COURSE OF DEALING AND USAGE OF TRADE, AND SOME SPECIFIC CONSTRUCTIONAL ISSUES

1. COURSE OF DEALING AND USAGE OF TRADE¹

A course of dealing between the parties and usage of trade have long been recognized as serving two important roles in relation to contracts of sale and other mercantile contracts. They have been used, first, to give meaning to the express language adopted by the parties and, secondly, to supplement or qualify the express terms of a contract with terms presumptively imported because of past dealings between the parties, or because they are commonly observed by members of a trade or merchants trading in a particular locality. *The Sale of Goods Act* recognizes these roles, but only fragmentarily;² the closest to a generalized statement is section 53 which provides as follows:

Where any right, duty or liability would arise under a contract of sale by implication of law, it may be negatived or varied by express agreement or by the course of dealing between the parties, or by usage, if the usage is such as to bind both parties to the contract.

This language falls far short of a comprehensive statement of the role of course of dealing or usage of trade: the section is only concerned with the exclusionary role of usage of trade and course of dealing. UCC 1-205(3), on the other hand, provides:

A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.

This provision leaves no doubt about the central role of these concepts. In our view, it would be desirable to incorporate a similar provision in the revised Ontario Act, and we so recommend.³

(a) COURSE OF DEALING

Neither course of dealing nor usage of trade is defined in the Ontario Act. A frequently quoted dictum of McCardie, J.,⁴ describes course of dealing as meaning that "past business between the parties raises an implication as to the terms to be implied in a fresh contract, where no express

¹See, generally, *Williston on Contracts* (3rd ed., 1961), Vol. 5, secs. 648-61; *Corbin on Contracts* (1960), Vol. 3, secs. 557-58; *Restatement of the Law, Contracts 2d*, secs. 246-49; *Benjamin's Sale of Goods* (1974), paras. 152, 925 and 156; Duesenberg and King, *Sales and Bulk Transfers Under the Uniform Commercial Code*, Bender's Uniform Commercial Code Service, Vol. 3, pp. 4-126 to 4-133; *Scrutton on Charterparties*, (18th ed., 1974), pp. 14 *et seq.*

²See, ss. 9(1), 15.3, 29(4) and 53.

³See, Draft Bill, s. 4.7(1).

⁴*Pocahontas Fuel Co. Inc. v. Ambatielos* (1922), 27 Com. Cas. 148, 152.

provision is made on the point at issue". UCC 1-205(1) defines the expression as "a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct".⁵ The Code definition emphasizes the essential ingredient of regular dealings, as contrasted with scattered transactions, and this requirement also appears in the Anglo-Canadian case law.⁶ Subject to what we say hereafter, we therefore recommend adoption of the Code definition of course of dealing in the revised Sale of Goods Act.⁷

We have considered whether it is necessary to retain the Code requirement of a "sequence" of previous conduct since, in our view, what matters is not the frequency of the parties' previous dealings, but whether it may "fairly be regarded as establishing a common basis of understanding";⁸ although there is some difference of opinion between us, we have no strong views either way. Our draft provision, however, does not require a "sequence" of previous conduct.⁹ It will also be noted from the use of the words "may fairly be regarded", that the Code definition adopts an objective test with respect to whether agreement on missing terms can be implied from the parties' previous dealings. In *McCutcheon v. David MacBrayne*,¹⁰ on the other hand, Lord Devlin was of the view that actual knowledge of, and assent to, express terms appearing in previous contracts concluded between the parties needed to be shown before such terms could be imported into subsequent agreements. This opinion has not, however, been followed in later cases.¹¹ On this point, too, therefore, the weight of judicial opinion supports the Code approach.

(b) USAGE OF TRADE

The Code definition of this expression, and its tests with respect to the admissibility of evidence of usage of trade, present greater difficulties. At least at first sight, the provisions of the Code appear to differ in several important respects from the common law test of admissibility generally adopted in England and Canada. UCC 1-205(2) reads in part:

A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question.

⁵Compare, UNCITRAL draft Convention (1977), Art. 7(1), which provides:
The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.

⁶For example, *J. Spurling Ltd. v. Bradshaw*, [1956] 1 W.L.R. 461, 467 (C.A.); *Henry Kendall & Sons v. Wm. Lillico & Sons Ltd.*, [1969] 2 A.C. 31, especially at p. 113 (H.L.); *Hollier v. Rambler Motors A.M.C. Ltd.*, [1972] 2 Q.B. 71 (C.A.).

⁷See, Draft Bill, s. 1.1(19).

⁸*Ibid.*

⁹*Ibid.*

¹⁰[1964] 1 W.L.R. 125, 134-35, [1964] 1 All E.R. 430, 437 (H.L.).

¹¹See, Benjamin, footnote 1 *supra*, para. 925.

UCC 1-205(4) further provides:

The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.

An authoritative English exposition,¹² on the other hand, requires that, to be admissible, “the custom [*sic*] must be reasonable, universally accepted by the particular trade or profession or at the particular place, certain, not unlawful and not inconsistent with the express or implied terms of the contract”.

The following points of difference between the common law test of admissibility adopted in England and Canada and the language of the Code require consideration.

(i) *Universal Acceptance*

This common law requirement appears to us to confuse the concepts of custom and usage. As Williston points out,¹³ there are important differences between these two concepts. A custom, once established, becomes part of the law of the land and is binding on the parties whether they know of it or not. There are, therefore, good reasons for requiring strict proof of its initial establishment. Usage of trade, as an element of a contract, is predicated on the parties' implied intentions; that is, what they may fairly have had in contemplation at the time of the formation of the contract. Universal acceptance of the usage at issue is not likely to have been contemplated by the parties. We agree with the Code¹⁴ that “regularity of observance”, such as to justify an expectation that the usage will be observed with respect to the transaction in question, is a more realistic assessment of the parties' intentions than a requirement of universality,¹⁵ and our draft provision follows the Code in this respect.¹⁶

(ii) *Certainty*

This common law requirement is not expressly included in the Code definition, but is implicit in the requirement of regularity of observance. A usage without a firm content is a contradiction in terms. As the Comment to the Code provision points out,¹⁷ however, where the precise amount of variation from the Code's general rules has not been worked out into a single standard (for example, with respect to the degree of deviation permitted in a contract for the supply of a commodity), “the party relying on the usage is entitled, in any event, to the minimum variation

¹²*Ibid.*, para. 844, paraphrasing Scruton, footnote 1 *supra*, p. 23.

¹³*Supra*, footnote 1, sec. 649.

¹⁴UCC 1-205(2).

¹⁵A “regularity of observance” test is also adopted in Art. 7(2) of the UNCITRAL draft Convention.

¹⁶See, Draft Bill, s. 1.1(1)25.

¹⁷UCC 1-205, Comment 9.

demonstrated". This adds a heavy gloss to the statutory definition. Our recommended draft definition of "usage of trade" does not deal with the point specifically; we think it best to leave it for the trier of fact to determine whether there is such regularity of observance with respect to a minimum permissible variation as to justify giving it effect.

(iii) *Reasonableness*

This requirement of the Anglo-Canadian test is also omitted from the Code definition, although it appears from Comment 6 to UCC 1-205 that the draftsmen intended the general test of unconscionability in UCC 2-302 to apply.¹⁸ Should, then, a requirement of reasonableness be incorporated specifically in the definition of "usage of trade"? On the face of it, it seems anomalous, as Williston has pointed out,¹⁹ that greater concern should be expressed for the reasonableness of terms implied by usage of trade, than for the same terms spelled out expressly in the agreement. He explains the apparent paradox²⁰ on the ground that, in the former case, there is only constructive assent to the implied terms; in the latter case, there is express assent. However, this distinction is only valid where the person sought to be bound by the usage is not a member of the trade in which the usage is observed; for example, a principal who retains the services of a broker to purchase goods on a commodities market.²¹ It would be odd, on the other hand, if brokers trading in the same market could plead ignorance of their own usages. The case law²² strongly suggests that a usage is much more likely to be found unreasonable in the first type of case (that is, where one of the parties is not a member of the trade in which the usage is observed), than in the second. The same result could be achieved by reasoning that, where a usage is seriously inimical to the interests of a person who is not a member of the group among whom it is observed, it cannot fairly be assumed that he intended it to apply to the transaction in question. Be that as it may, the concept of reasonableness occupies such an established place in the jurisprudence that we think it should be retained as part of the definition of usage of trade, and we so recommend.²³ On the basis of past precedents, the courts should have no difficulty in distinguishing its differential role depending on the status of the person sought to be charged with the usage.

(iv) *Inconsistency*

Once again there are serious analytical difficulties about taking at face value the common law proposition that a usage that is inconsistent with the

¹⁸However, as Professor Patterson points out in NYLRC Study, ch. 5, footnote 52, *supra*, at pp. (326-27), the Comment is misleading, since UCC 2-302 only applies to Article 2 transactions.

¹⁹*Supra*, footnote 1, sec. 658.

²⁰*Ibid.*, sec. 659.

²¹This was true in the leading case of *Robinson v. Mollet* (1875), L.R. 7 E. and I. App. 802. See, also, the persuasive distinction drawn in *Restatement of the Law, Contracts 2d* between the relevance of reasonableness of a usage when invoked to interpret an agreement, and its relevance to supplement or qualify the terms of the agreement: sec. 246, Comment *c*, and sec. 247, Comment *a*.

²²See the cases cited in Scrutton, footnote 1 *supra*, pp. 17 *et seq.*

²³See, Draft Bill, s. 1.1(1)25.

express terms of the agreement, or with the terms that would otherwise be implied at law, is not admissible to interpret or supplement the agreement. As others have pointed out,²⁴ such a proposition, taken to its logical conclusion, would exclude evidence of all usages, since, by definition, all such evidence must vary the literal terms of the agreement; otherwise there would be no point in introducing it. It may be that the parties have consciously adopted express language with a view to overriding an implied term that would otherwise be annexed by usage; but a simple test of inconsistency does not appear to us sufficient to evince such an intention. As in the case of the parol evidence rule, there is, in our view, no simple linguistic formula, no rule of thumb, that can resolve the difficult constructional problems. UCC 1-205(4) starts with the admonition that express terms and any applicable usage of trade or course of dealing shall be construed "wherever reasonable" as consistent with one another; it is only when such a construction is "unreasonable" that the extrinsic evidence must yield to the express language of the contract.²⁵ We think that this is a more helpful way of stating the task confronting the court than a test of inconsistency. Admittedly, a test of reasonableness leaves as much to judicial discretion as a test of inconsistency,²⁶ but at least the Code formulation is heavily biased towards admissibility. We therefore favour a test of reasonableness in preference to the traditional common law test, and our definition of "usage of trade" does not include a test of consistency.

(c) CONCLUSION

Our overall conclusion is that the revised Act should explicitly recognize course of dealing and usage of trade as constructional tools and sources of implied terms of the agreement.²⁷ We are also of the view that the Code description of these terms,²⁸ and of their relationship to each other and to the express terms of the agreement,²⁹ are suitable for adoption in the revised Ontario Act.

2. UNCERTAINTY OF TERMS³⁰

(a) GENERAL CONSIDERATIONS

Businessmen are often men on the wing. They do not write agreements with the precision or elegance of an equity draftsman. Not infre-

²⁴Scrutton, footnote 1 *supra*, p. 19; Williston, footnote 1 *supra*, sec. 652, especially at p. 42.

²⁵The same test is applied in *Restatement of the Law, Contracts 2d*, sec. 228(5).

²⁶See, the Code cases cited in Duesenberg and King, footnote 1, *supra*, p. 4-132, n. 71.

²⁷See, Draft Bill, s. 4.7.

²⁸See, Draft Bill, ss. 1.1(1)9 and 1.1(1)25.

²⁹*Ibid.*, s. 4.7(4). It will be noted that, in order to avoid unnecessary duplication of provisions, we have combined these aspects of UCC 1-205 and the corresponding aspects of UCC 2-208(2), so as to produce a single integrated provision.

³⁰See, also, Neilson, "The Uncertainty of Terms in Sale Transactions", Research Paper No. II.5.

quently, there are elements of uncertainty or ambiguity about one or more terms of the bargain. Some important terms may be left unstated. Others may be sketched in broad outline, the parties' intention being to complete the details at a later date. In long term agreements, or in periods of intense inflation, the parties may recognize the difficulty of fixing in advance the price of a commodity subject to sharp market fluctuations, and therefore leave it to be decided by future agreement.

In all these cases the law is confronted with a basic dilemma: to what extent can, or should, it make good the deficiencies in the parties' agreement? Two conflicting principles can be discerned in the abundant case law involving this range of problems. The one declines to become a mender of imperfect bargains, and abides by the rule that a contract that fails to specify the essential elements of the agreement is void for uncertainty. The other, persuasively articulated in Lord Wright's masterful judgment in *Hillas & Co. v. Arcos*,³¹ seeks to uphold commercial agreements wherever possible by invoking "the legal implication in contracts of what is reasonable, which runs throughout the whole of modern English law in relation to business contracts". The conflict in judicial attitude is particularly acute in those cases in which the parties have expressly left one or more terms, typically terms involving the price, to be decided by future agreement.

The criticism has been made³² that the courts that refuse to enforce such agreements frequently confuse two very different questions. The first question is whether, on the basis of the available evidence, the parties believed they had entered into a binding agreement. Secondly, if this was their intention, is there some reasonable basis upon which the court can complete the unsettled term? According to this criticism,³³ the assumption that an "agreement to agree" clause is inconsistent with the intention to conclude an immediately binding bargain, flies in the face of commercial realities and would potentially invalidate many agreements concluded every day. A more attractive supposition is that the parties intended reasonable terms to govern the missing elements in the unlikely event that they were unable to reach agreement by themselves. There could be exceptions. The intensely subjective nature of the missing terms, or the absence of objective data upon which the court could substitute its judgment for the parties' agreement, might point to the conclusion that the parties did not mean to be bound until the terms were settled. However, this type of approach is very different from the one that rejects out of hand an apparent agreement that is tainted with a clause requiring future agreement on one or more terms.

(b) UNCERTAINTY AS TO PRICE

The Sale of Goods Act offers only limited assistance in the resolution of the problems referred to above. Where the contract is silent as to price, section 9(2) of the Act provides that the buyer shall pay a reasonable price. However, it was held by the House of Lords in *May and*

³¹(1932), 147 L.T. 503 (H.L.), 517.

³²Neilson, footnote 30 *supra*, pp. 9-10.

³³*Ibid.*, pp. 42 *et seq.*

Butcher, Limited v. The King,³⁴ that this provision cannot be invoked where the price has been expressly reserved for future agreement. Where silence surrounds other terms, the presumptive rules of the Act concerning the implied conditions and warranties of title and quality,³⁵ the time of transfer of the property,³⁶ the place and time of delivery,³⁷ the buyer's payment obligations,³⁸ and so forth, will come into play as gap fillers. But in these cases, as in the case of price, there is no guiding principle to assist the courts where the parties appear to have reserved the question for future agreement.

One of the great merits of Article 2 is that it rectifies this omission. Section 2-204(3) provides as follows:

- (3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

The Commission agrees with the approach taken by this provision. In our view, where the parties have intended to enter into a binding contract of sale and there is a reasonably certain basis for giving an appropriate remedy, the contract should not fail by reason of the absence of one or more terms, even where such terms have been left open for future agreement. Accordingly, we recommend the inclusion in the revised Act of a provision similar to UCC 2-204(3).³⁹

Section 2-305 spells out the implications of the approach taken in UCC 2-204(3) in the specific context of price. The section reads as follows:

- (1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if
 - (a) nothing is said as to price; or
 - (b) the price is left to be agreed by the parties and they fail to agree; or
 - (c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.
- (2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.
- (3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

³⁴[1934] 2 K.B. 17 n. (H.L.).

³⁵Ss. 13-16.

³⁶Ss. 18-19.

³⁷S. 28.

³⁸S. 27.

³⁹See, Draft Bill, s. 4.2(4).

- (4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

It will be observed that the operative principle of section 2-305 turns on whether the parties intended to enter into a binding contract, not on whether they reserved for future agreement the price to be paid by the buyer. Combined with the surrounding circumstances, a clause reserving for future agreement the price to be paid *may* be evidence of an intention not to be bound until the missing term is completed; but it is not conclusive. We support the Code's approach in respect of price as well as in respect of other unsettled terms and, subject to the modifications dealt with below, recommend its adoption in the revised Ontario Sale of Goods Act in place of sections 9 and 10 of the existing Act dealing with price.⁴⁰

A number of other differences should be noted between section 2-305 and sections 9 and 10 of *The Sale of Goods Act*. Section 10 provides that, where the price is to be fixed by the valuation of a third party and he cannot or does not make the valuation, the agreement is avoided subject to the buyer's obligation to pay for any goods that have been delivered to or appropriated by him. It is not entirely clear how the same problem is intended to be dealt with under the Code. Section 2-305(1)(c) refers to a price to be fixed "in terms of some agreed market or other standard", thus permitting the inference that the reasonable price formula is not to be applied where the valuation is to be made by a particular person. However, such a literal construction would run counter to the basic principle expressed in the first sentence of the subsection, and is in conflict with the examples cited in Comment 4 to the section. We therefore recommend that the Ontario version of section 2-305(1)(b) be amended to read as follows:

- (b) the price is left to be agreed by the parties or a third person and they fail to agree or the third person fails to fix the price.

Section 2-305 also differs from section 10 in its treatment of the consequences where the price fails to be fixed, other than where the price is to be fixed by agreement, through the fault of one of the parties. UCC 2-305(3) affords the innocent party the option of treating the contract as cancelled⁴¹ or himself fixing a reasonable price.⁴² Under the corresponding provision in section 10(2) of *The Sale of Goods Act*, which is limited to cases where a third party is prevented from making the valuation by the fault of the seller or buyer, the innocent party is restricted to

⁴⁰Ibid., s. 5.3.

⁴¹"Cancellation" is defined in UCC 2-106(4) as occurring when either party puts an end to the contract for breach by the other but without prejudice to any remedy he may have for breach of contract.

⁴²Some commentators have noted an apparent conflict between sections 2-305(3) and 2-305(1)(c) where the failure of the third person to fix a price under the latter provision is due to the fault of one party. We have proceeded on the assumption that, in such a case, subsection (3) prevails.

an action in damages. Comment 5 to UCC 2-305 explains the Code's option as an example of a failure to take cooperative action, "thus shifting to the aggrieved party the reasonable leeway in fixing the price". A comparable approach is taken in UCC 2-311(3) with respect to other failures in cooperation by one or the other party. Later in this chapter,⁴³ we recommend adoption of UCC 2-311(3) subject to a minor modification. The Commission is of the view that a provision similar to UCC 2-305(3) should also be included in the revised Ontario Act.⁴⁴

(c) OUTPUT, REQUIREMENTS, AND EXCLUSIVE DEALINGS CONTRACTS⁴⁵

An important range of commercial contracts that is not referred to at all in *The Sale of Goods Act* involves output, requirements, and exclusive dealings contracts. In an output contract, the supplier undertakes to sell his total output of a specified product to the buyer. In a requirements contract, the buyer obligates himself to meet all his requirements from the seller. In an exclusive dealings contract, the seller agrees to appoint the buyer as his exclusive "selling agent" in a territory designated for the purpose. An exclusive dealings and a requirements contract may overlap.

These types of contract are well established and serve important commercial purposes. An output contract provides the seller with a firm outlet for his product, and enables him to plan his production more rationally; indeed, in some instances, he might not find it economical to build a manufacturing plant without such a commitment. A requirements contract provides the buyer with an assured source of supply of raw materials. Exclusive dealings contracts are geared to distributive and merchandising techniques; they are designed to provide a merchant with an incentive to handle a new line of goods when he might otherwise be reluctant to do so. Because of their restrictive features, exclusive dealings contracts may raise problems relating to restrictive trade practices.⁴⁶

(i) *Output and Requirements Contracts*

Output and requirements contracts raise at least three distinct questions. The first question relates to consideration, the second to indefiniteness, and the third to the scope of the obligations undertaken by the parties.

The first question is whether there is sufficient consideration to support the enforceability of the bargain. Some early American cases raised this question⁴⁷ on the ground that, in a requirements contract, the buyer

⁴³*Infra*, sec. 2(e).

⁴⁴See, Draft Bill, s. 5.3(4).

⁴⁵See, Waddams, "Output and Requirement Contracts and Exclusive Dealing (UCC 2-306)", Research Paper No. II.9C; and compare, White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), pp. 103-109, and Comments in (1954), 102 U. Pa. L. Rev. 654, and (1965), 78 Harv. L. Rev. 1212.

⁴⁶See, the *Combines Investigation Act*, R.S.C. 1970, c. C-23, as am. by S.C. 1974-75-76, c. 76, s. 12, adding s. 31.4.

⁴⁷See, Duesenberg and King, footnote 1 *supra*, pp. 4-48/49.

did not promise to have any requirements. The converse reasoning could be applied in an output contract. The argument appears particularly appealing where, in the case of a requirements contract, the buyer has no established business and there are no benchmarks to indicate his probable requirements.⁴⁸ Nevertheless, later pre-Code cases⁴⁹ rejected these objections, and reasoned that there was consideration for the buyer's promise in a requirements contract since he restricts his freedom by binding himself to do one of two things — to buy from the particular seller or not to buy at all.⁵⁰ UCC 2-306(1), which will be discussed more fully hereafter, contains the Code provision on output and requirements contracts but does not address itself to the problem of consideration. It is clear, however, from Comment 2 to the section that the draftsmen endorsed the later pre-Code position.

The Anglo-Canadian authorities on this question are sparse,⁵¹ but would appear to support the argument that sufficient consideration exists to make output and requirements contracts enforceable. We have considered whether the revised Ontario Act should include a statement to this effect, but have concluded that it is not necessary. As will be seen, we recommend below the adoption of a modified version of UCC 2-306(1). Since it assumes the enforceability of output and requirements contracts, this should, in our view, be sufficient.

A closely related question, raised in some American cases,⁵² is whether an output or requirements contract may be incapable of enforcement because of indefiniteness. In these cases, the courts seem to have been impressed with the difficulty of determining the parties' obligations, especially, once again, in those cases where the buyer had no established business or, in the case of an agent or jobber, where his requirements might be subject to sharp fluctuations. This defence, too, appears to have been rejected by the majority of American courts, and is explicitly rejected in the Code Comments to section 2-306. As has been observed in a leading American textbook,⁵³ "the mere existence of an open quantity term does not support invalidation, since indefiniteness is inherent in requirements contracts".

This particular aspect of output and requirements contracts does not appear to have been canvassed in the Anglo-Canadian authorities, although, of course, our courts are no strangers to problems of uncertainty in other areas of contract law. For the same reasons that were advanced with respect to the issue of consideration, we see no need for a special statutory provision relating to indefiniteness.

⁴⁸Ibid.

⁴⁹A leading case is *In re United Cigar Stores Co. of America* (1934), 8 F. Supp. 243 (N.Y. Dist. Ct.), aff'd (1934), 72 F. (2d) 673 (2nd Cir.).

⁵⁰*Texas Co. v. Pensacola Maritime Corp.* (1922), 279 F. 19 (5th Cir.).

⁵¹See, for example, *In re Gloucester Municipal Election Petition 1900 (Tuffley Ward)*, [1901] 1 K.B. 683; and *Percival Ltd. v. L.C.C. Asylums and Mental Deficiency Committee* (1918), 87 L.J.K.B. 677; Waddams, footnote 45 *supra*, pp. 3-5.

⁵²See, Duesenberg and King, footnote 1 *supra*, p. 4-47; White & Summers, footnote 45 *supra*, p. 104.

⁵³White & Summers, footnote 45 *supra*, p. 104.

The third question is by far the most difficult and, of the questions here discussed, has attracted most of the litigation in the U.S.⁵⁴ This question raises the issue of the scope of the obligations undertaken by the parties. To what extent may a buyer abnormally increase or decrease his requirements? May he justify discontinuing any requirements? A parallel set of issues arises with respect to the supplier's obligation under an output contract. The abundant American case law admits of no easy generalization, but suggests two principal tests: namely, what did the parties reasonably contemplate at the time the contract was concluded, and was the party alleged to be in default acting in good faith? Thus a buyer starting a new business may be expected to have a substantial, perhaps even a dramatic, increase in his requirements; but he acts in bad faith if he increases his orders simply to take advantage of an unusual rise in the market price, or in anticipation of the supplier terminating the contract. Again, technological changes may justify reduced requirements, but not the availability of a cheaper substitute. The Anglo-Canadian authorities are few in number.⁵⁵ It has been suggested,⁵⁶ however, that they allow a greater margin of discretion to the buyer or seller in varying his output or requirements, as the case may be, at least where he has not acted in bad faith.

Article 2 addresses itself to the problem in section 2-306(1), which provides as follows:

- (1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

The extent to which this provision changes pre-Code law is not clear. The uniform requirement of good faith introduces no new element. The difficulty arises because of the importance attached in UCC 2-306(1) to any stated estimate of output or requirements in the contract or, in the absence of a stated estimate, to any "normal or otherwise comparable prior output or requirements". In such cases no "unreasonably disproportionate" quantity may be tendered or demanded. It seems that the draftsmen intended these benchmarks to be applied literally, and not merely to serve as constructional aids.⁵⁷ If this is correct, their effect could be very confining. Suppose a bakery agrees to purchase all of its sugar requirements from a sugar refinery. Because of a steep increase in the price of sugar, the demand for the bakery's products falls sharply and the bakery only orders one half of its previous requirements of sugar. The bakery might be held to be in breach, though acting in perfectly good faith and even though the contract did not stipulate a minimum or maximum quantity of sugar. The bakery would still face the complaint that its reduced requirements were unreasonably disproportionate to its prior requirements.

⁵⁴Compare, Duesenberg and King, footnote 1 *supra*, pp. 4-52 *et seq.*; White & Summers, footnote 45 *supra*, pp. 104 *et seq.*

⁵⁵Waddams, footnote 45 *supra*, pp. 5 *et seq.*

⁵⁶*Ibid.*, pp. 12-13.

⁵⁷See, UCC 2-306, Comment 3; White & Summers, footnote 45 *supra*, p. 107.

In our view, a court should not be obliged to come to such a conclusion. It has been suggested⁵⁸ that “unreasonably disproportionate” still allows for ample elasticity. This may be so, although it runs counter to the language of Comment 3 to section 2-306. We recommend that the revised Ontario Act make it clear that stated estimates and prior output or requirements figures should serve as guidelines, and not as mandatory rules, in determining the parties’ intention. We think this change could be accomplished by adoption of the following language:⁵⁹

An agreement that measures the quantity of goods to be bought or sold by the output of the seller or the requirements of the buyer means such reasonable quantity as may be required or supplied by the buyer or seller acting in good faith, having regard to any stated estimates, any previous output or requirements, and all the circumstances of the case.

(ii) *Exclusive Dealings Contracts*

Exclusive dealings contracts frequently overlap with output and requirements contracts. To the extent that they do, it is not necessary to repeat what has already been said under the previous heading. The inter-related questions raised by exclusive dealings contracts concern the extent to which such contracts are supported by consideration, and the scope of the obligations undertaken by the parties.

Since Cardozo J’s well known decision in *Wood v. Lucy, Lady Duff-Gordon*,⁶⁰ it has generally been accepted by American courts that an exclusive agency agreement is enforceable because the agent impliedly undertakes to use his best efforts to promote the sale of the principal’s goods, thereby furnishing consideration. The principle is now recognized in the Code. Section 2-306(2) provides:

A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

The requirement of a “lawful” agreement in line 1 is a reference to common law and statutory restrictions that may apply to exclusive dealing agreements. It will be observed, too, that the subsection only addresses itself to the implied obligation undertaken by the recipient of the exclusive rights, and not to the consideration that supports the agreement. The two are, of course, interchangeable.

The Anglo-Canadian position is less clear. In *Warren v. Agdehsman*⁶¹ an implied promise was found by the agent “not to decline reasonably to introduce customers”. In *Christopher v. Essig*⁶² an exclusive agency

⁵⁸White & Summers, footnote 45 *supra*, p. 106.

⁵⁹See, Draft Bill, s. 5.4(1).

⁶⁰(1917), 118 N.E. 214 (N.Y. Ct. App.).

⁶¹(1922), 38 T.L.R. 588 (K.B.).

⁶²[1948] W.N. 461 (K.B.).

for the sale of real property was held to imply a promise by the agent that he would use his best efforts to sell the property. On the other hand, in *Tobias v. Dick and T. Eaton Co.*⁶³ and, more recently, in *Schroeder Music Publishing Co. v. Macaulay*,⁶⁴ the courts refused to subscribe to any such general implication.

In our view, in the absence of contrary indications, the general presumption should be that the person receiving the exclusive benefit will use his best efforts, for otherwise the agreement does not make commercial sense. We therefore support the principle of UCC 2-306(2). However, the language of the subsection is a little too compressed, and we, therefore, recommend the adoption of the following provision:

Where the buyer lawfully agrees to buy goods exclusively from the seller or the seller lawfully agrees to sell goods exclusively to the buyer, there is, unless the circumstances show a contrary intention, an obligation by the seller to use his best efforts to supply the goods and by the buyer to use his best efforts to promote their sale.

This provision is contained in our Draft Bill.⁶⁵

(d) CONTRACTS OF INDETERMINATE DURATION⁶⁶

A contract for the supply and purchase of goods may envisage successive performances; for example, a contract to supply a factory with its requirements of fuel oil, or a contract to supply a supermarket with its requirements of a particular shelf item. It happens not infrequently that contracts of this nature fail to state their duration. In such cases, what inferences are to be drawn from silence? There are several possibilities. One is to imply a presumption of perpetual duration. Another is to imply a presumption of terminability at will, subject to the giving of reasonable notice. An intermediate solution is to imply a minimum period of duration, following which the contract would, as in the second case, be terminable on reasonable notice. The problem has been extensively litigated in the U.S.,⁶⁷ with conflicting results. It has received much less judicial attention in England and Canada.

The initial English response, as illustrated by *Llanelly Ry. & Dock Co. v. London and North Western Railway Co.*,⁶⁸ was to imply a presumption of perpetual duration. This extreme interpretation has yielded

⁶³[1937] 4 D.L.R. 546 (Man. K.B.).

⁶⁴[1974] 1 W.L.R. 1308 (H.L.).

⁶⁵See, Draft Bill, s.5.4(2).

⁶⁶See, also, Waddams, "Effect of Absent Time Provisions in Sales Contracts (UCC 2-309)", Research Paper No. II.9B; and Carnegie "Terminability of Contracts of Unspecified Duration" (1969), 85 L.Q.R. 392.

⁶⁷See, Buckner, "Termination by Principal of Distributorship Contract Containing No Express Provision For Termination" (1968), 19 A.L.R. 3d 196; and Gellhorn, "Limitations on Contract Termination Rights-Franchise Cancellations", [1967] Duke L.J. 465.

⁶⁸(1875), L.R. 7 E. and I. App. 550; compare, *Coniagas Reduction Co. Ltd. v. Hydro-Electric Power Commission of Ont.* (1928), 35 O.W.N. 89 discussed in (1930), 8 Can. Bar Rev. 153 (H.C.J.).

in later cases⁶⁹ to a presumption of terminability on notice. Presumably the latter, more moderate, interpretation would now also be applied in Ontario, for, as a learned commentator has reasoned,⁷⁰ a presumption of perpetual duration imposes "an excessively severe penalty for the misdemeanour of careless draftsmanship". It also ascribes to the parties what in most cases must be quite a fictitious view of their intention.

The majority of American decisions⁷¹ favour terminability at will, with or without the requirement of a reasonable period of notice, but some courts have implied a period of *minimum* duration before the contract can be terminated.⁷² This latter construction appears to have influenced Article 2. Section 2-309(2) and (3) reads as follows:

(2) Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.

(3) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.

As has been noted,⁷³ these provisions are both obscure and contradictory. Read literally, subsection (2) suggests two principles: (a) that the contract expires automatically after a reasonable period of operation unless it has been terminated sooner; and, (b) that, notwithstanding the requirement of notice in subsection (3), the contract can be terminated "at any time". There has been very little judicial discussion⁷⁴ of these drafting infelicities, but it seems safe to assume that a literal reading was not intended.

The Commission supports a presumption of terminability at will, coupled with a requirement of reasonable notice. There may be cases where the surrounding circumstances favour a construction of perpetual duration, but they must surely be rare. Our recommendation would not, of course, preclude a court from reaching such a result, but the initial presumption would be in the opposite direction. While we do not deny its attractions, we have decided not to support a presumption of minimum duration. Our opposition to it is based in part on the novelty of such an approach in Anglo-Canadian law, and in part on our belief that such a

⁶⁹For example, *Crediton Gas Co. v. Crediton U.D.C.*, [1928] 1 Ch. D. 447 (C.A.); *Martin Baker Aircraft Co. Ltd. v. Can. Flight Equipment Ltd.*, [1955] 2 Q.B. 556; *Nat. Bowling & Billiards Ltd. v. Double Diamond Bowling Supply Ltd. and Automatic Pinsetters Ltd.* (1961), 27 D.L.R. (2d) 342 (B.C. S.C.). See also *Chitty on Contracts*, (24th ed., 1977), Vol. 1, para. 799, p. 798.

⁷⁰Carnegie, footnote 66 *supra*, at p. 411.

⁷¹See, Buckner, footnote 67 *supra*, especially at pp. 233 *et seq.*

⁷²*Ibid.*, pp. 319 *et seq.*

⁷³Waddams, footnote 66 *supra*, pp. 8-9. Compare, NYLRC Study ch. 5, footnote 52, *supra*, p. (383).

⁷⁴See, for example, *Weilersbacher v. Pittsburgh Brewing Co.* (1966), 218 A. 2d 806 (Pa. S. Ct.); *Goldinger v. Boron Oil Co.* (1974), 375 F. Supp. 400 (D. Penn.); *Superior Foods Inc. v. Harris-Teeter Super Markets Inc.* (1975), 217 S.E. 2d 566 (N.C. S.Ct.). None of these decisions in fact analyzes UCC 2-309(2), although they purport to apply it.

presumption is not really necessary. The requirement of reasonable notice should be sufficient to protect the other party's interests in most cases, and should accomplish the same result as a period of minimum duration followed by a short period of notice. What is "reasonable notice" will, of course, depend on all the circumstances. A large initial investment by the supplier or buyer will call for a longer period of notice than cases where the investment is negligible, or where there are readily accessible and alternative sources of supply or demand. Other relevant factors have been canvassed in the abundant literature that now exists⁷⁵ on the question in the context of franchising agreements.

Accordingly, the Commission recommends that, where a contract provides for successive performances but is silent as to duration, there should be a presumption that the contract is terminable at will, subject to a requirement of reasonable notice. There should not be a presumption of minimum duration. Our Draft Bill reflects these recommendations.⁷⁶

Finally, there is the question whether the parties should be free to dispense with the requirement of notice of termination. It will be noted that UCC 2-309(3) permits a clause dispensing with notice, unless "its operation would be unconscionable". At first blush, this seems to say no more than that such a waiver is subject to the unconscionability provision in UCC 2-302 that governs all contractual provisions. However, this is not quite correct. There is a difference. Pursuant to UCC 2-302, the court must find the contract or the impugned clause to have been unconscionable "at the time it was made"; under UCC 2-309(3), on the other hand, the court may enlarge its horizons and also consider the actual impact of the waiver clause as of the time of its operation.⁷⁷ The clause may have been quite reasonable when initially adopted, but may later acquire a potency not originally contemplated by the parties. The Commission is of the view that the parties should be free to agree to dispense with the requirement of notice of termination, provided that the operation of such an agreement would not be unconscionable.

We have also considered whether the revised Act should go further, and shift the burden to the terminating party to satisfy the court that the clause dispensing with notice was not unconscionable. We have decided against this course of action because franchising and supply agreements differ too widely to admit of easy generalizations. We have also been persuaded that it would be a futile gesture, since the terminating party could easily evade any provision shifting the onus by the simple expedient of agreeing to a short period of notice. To meet this objection, any provision shifting the burden of proof would have to embrace all clauses that do not require "reasonable" notice. But even in such a case, there would still be the preliminary issue of whether the contractually required notice was reasonable. The aggrieved party would bear the onus of proving that the notice was unreasonable. In our view, it involves little additional effort on

⁷⁵See, footnote 55 *supra*, and, also, Comment, "Franchise Distribution Agreements", [1969] Duke L.J. 959, and Vesely, "Franchising as a Form of Business Organization — Some Legal Problems" (1977-78), 2 C.B.L.J. 34.

⁷⁶See, Draft Bill, s. 5.7(2).

⁷⁷Compare, Duesenberg & King, footnote 1 *supra*, pp. 4-108 to 4-110.

the part of the aggrieved party to carry the full burden of proof of unconscionability.

In conclusion, we recommend that a provision comparable to UCC 2-309(3) be included in the revised Sale of Goods Act. Our Draft Bill contains such a provision.⁷⁸

(e) OPTIONS AND COOPERATION RESPECTING PERFORMANCE

UCC 2-311 provides:

(1) An agreement for sale which is otherwise sufficiently definite (subsection (3) of Section 2-204) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

(2) Unless otherwise agreed specifications relating to assortment of the goods are at the buyer's option and except as otherwise provided in subsections (1)(c) and (3) of Section 2-319 specifications or arrangements relating to shipment are at the seller's option.

(3) Where such specification would materially affect the other party's performance but is not seasonably made or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies

(a) is excused for any resulting delay in his own performance; and

(b) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods.

The section has no counterpart in the Ontario Sale of Goods Act.

Subsection (1) addresses itself to another aspect of the problem of indefiniteness. Like UCC 2-305, the section on price, it adopts the very commercial point of view that contracts of sale are not to be stigmatized as void for uncertainty because particulars of performance are to be specified by one of the parties; for example, the selection of lumber from among an agreed range of sizes where the total quantity has been fixed. Early American cases⁷⁹ regarded such contracts as too indefinite — at any rate where the contract was still executory — because there was no basis upon which the court could assess damages if the party in breach failed to make the selection. Later cases⁸⁰ rejected this approach and focused on

⁷⁸See, Draft Bill, s. 5.7(3).

⁷⁹For example, *Wheeling Steel & Iron Co. v. Evans* (1903), 55 A. 373 (Md. Ct. App.). See, further, Comment, "Specification and Apportionment Contracts: Common Law and Uniform Commercial Code" (1956), 23 U. Chi. L. Rev. 499, 500 *et seq.*, and (1937), 106 A.L.R. 1284.

⁸⁰See, Comment, (1956), 23 U. Chi. L. Rev. 499, 502 *et seq.*

the question whether or not the party in breach had assumed an obligation, and not merely the power, to make the selection. This approach also appears to reflect prevailing Anglo-Canadian doctrine, as sanctioned by the House of Lords in *Hillas & Co. Ltd. v. Arcos Ltd.*⁸¹ The concluding sentence of UCC 2-311(1) imposes a duty of good faith and commercial reasonableness on the party obliged to provide the specifications. This requirement, too, is found in our case law⁸² and flows logically from the adoption of any general doctrine of good faith.

Subsection (2) addresses itself to the occasional situation where the contract is silent with respect to the allocation of options involving assortment of goods and shipping arrangements. Apparently, its purpose is⁸³ to reject a pre-Code rule, which has no modern Anglo-Canadian counterpart in the law of sales, but seemingly traces its origin to Coke.⁸⁴ The rule states that the option lies with the party "first under a duty to move". We agree with the Comment to the Code provision⁸⁵ that subsection (2) accords better with the usual commercial interpretation applied to such circumstances. It should be emphasized that the subsection only applies in the absence of any contrary agreement between the parties, and agreement here, as in other cases of construction, includes usage of trade and course of dealing between the parties.

Subsection (3) presents greater difficulties. It is well settled in our law⁸⁶ that, where there is a failure of cooperation, the innocent party is excused for any resulting delay in his own performance. Clause (a) is in accord with this common sense proposition. The difficulties arise because clause (b) also authorizes the innocent party "[to] proceed to perform in any reasonable manner". This power is not, apparently, supported by existing Anglo-Canadian law, and is contrary to the weight of pre-Code American authority.⁸⁷ Two objections were raised at common law against the power of an innocent party to proceed unilaterally with performance. The first was that contracts that gave the party not at fault a power of selection or specification were too uncertain to be capable of enforcement. This objection has already been dealt with above, and is disposed of in UCC 2-311(1). The other, more substantial, objection was that the power conflicted with the breaching party's right to have damages assessed in the manner least onerous to him. We agree with a learned commentator⁸⁸

⁸¹(1932), 14 T.L.R. 503, [1932] All E.R. 494, 38 Com. Cas. 23 (H.L.). Compare, *Canada Egg Products Ltd. v. Can. Doughnut Co. Ltd.*, [1955] S.C.R. 398, [1955] 3 D.L.R. 1. See, also, Burrows, "Contractual Co-operation and the Implied Term" (1968), 31 Mod. L. Rev. 390.

⁸²As illustrated by the *Arcos* case, *supra*. We are not, of course, suggesting that there is a general doctrine of good faith in Anglo-Canadian law applicable to the performance of contractual obligations.

⁸³See, UCC 2-311, Comment 2.

⁸⁴Co. Litt. 145a, cited in *Williston on Contracts*, (3rd ed., 1961), Vol. 11, s. 1407, n. 4.

⁸⁵*Supra*, footnote 83.

⁸⁶See, *Benjamin's Sale of Goods* (1974), para. 614. The leading case is *Mackay v. Dick* (1881), 6 A.C. 251 (H.L. (Sc.)).

⁸⁷NYLRC Study, ch. 5, footnote 52, *supra*, pp. (667) to (669); Comment, footnote 79 *supra*, especially pp. 500 *et seq.*

⁸⁸Comment, footnote 79 *supra*, at pp. 507 *et seq.*

that the Code adequately protects the party in breach: first, by the requirement in UCC 2-311(3)(b) that the aggrieved party, if he elects to proceed, must proceed in "any reasonable manner"; and, secondly, by the general obligation of good faith that binds all contracting parties.

We believe, therefore, that these objections have been answered satisfactorily. What is not so clear is whether UCC 2-311(3)(b) entitles the aggrieved party to proceed, even though the defaulting party has manifested a clear intention to repudiate the contract. It is reasonable to assume that, in such a case, the draftsman intended the Code's provisions on repudiation⁸⁹ to apply, and we think this should be made clear. Subject to this proviso, we recommend adoption of UCC 2-311 in the revised Ontario Act, and our Draft Bill contains a provision to this effect.⁹⁰

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The revised Act should explicitly recognize course of dealing between the parties and usage of trade as constructional tools and sources of implied terms of the agreement between the parties. Accordingly, a provision similar to UCC 1-205(3) should be incorporated in the revised Sale of Goods Act.
2. The definition of "course of dealing" should be based on UCC 1-205(1). It should emphasize the essential ingredient of regular dealings between the parties and should adopt an objective test with respect to whether agreement on missing terms can be implied from the parties' previous dealings. Accordingly "course of dealing" should be defined in the revised Act to mean "previous conduct between the parties to a transaction that may fairly be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct".
3. The common law definition of "usage of trade", which requires that, to be admissible in evidence, a usage must be, among other things, certain, universally accepted and not inconsistent with the express or implied terms of the contract, should not be adopted. Rather, a definition of the term similar to that contained in UCC 1-205(2) should be included in the revised Act. Specifically, "usage of trade" should be defined as "any reasonable practice or method of dealing that is observed in a place, vocation or trade with such regularity as to justify an expectation that it will be observed with respect to a transaction in question".
4. The revised Act should also incorporate provisions similar to those contained in UCC 1-205 dealing with the relationship of course of dealing and usages of trade to each other and to the express terms of the agreement.

⁸⁹See, UCC 2-610, 2-611, 2-703, 2-704.

⁹⁰See, Draft Bill, s. 5.9.

5. Where the parties have intended to enter into a binding contract of sale and there is a reasonably certain basis for giving an appropriate remedy, the contract should not fail by reason of the absence of one or more terms even where they have been left open for future agreement. Accordingly, a provision similar to UCC 2-204(3) should be included in the revised Act.
6. A section similar to UCC 2-305 dealing with uncertainty as to price should, subject to minor modifications dealing with the fixing of the price by a third person, and the remedies of the innocent party where the price fails to be fixed through the fault of one of the parties, be substituted for sections 9 and 10 of *The Sale of Goods Act*.
7. There should be inserted in the revised Act a provision, similar to UCC 2-306(1), dealing with the construction of output and requirements contracts. Unlike UCC 2-306(1), however, the provision in the revised Act should provide that stated estimates and prior output or requirements figures should serve as guidelines in determining the parties' intention concerning their obligations under the contract, and not as mandatory rules.
8. The revised Act should also contain a provision, similar to UCC 2-306(2), dealing with the construction of exclusive dealing contracts. This provision should contain a presumption that the seller will use his best efforts to supply, and the buyer his best efforts to sell, the goods.
9. It is unnecessary to provide explicitly that output and requirements contracts and exclusive dealing contracts are not unenforceable by reason of indefiniteness or lack of consideration.
10. Where a contract provides for successive performances but is silent as to duration, there should be a presumption that the contract is terminable at will, subject to a requirement of reasonable notice. There should be no presumption of minimum duration.
11. As in UCC 2-309(3), the parties to a contract of the type referred to in recommendation No. 10, *supra*, should be free to agree to dispense with the requirement of notice of termination, provided that the operation of such an agreement would not be unconscionable.
12. A provision, similar to UCC 2-311, dealing with options and cooperation respecting performance, should be included in the revised Act, subject to an amendment to subsection (3)(b) to make it clear that the subsection is to be read subject to the provisions in the revised Act concerning repudiation.

CHAPTER 9

THE SELLER'S IMPLIED WARRANTIES (CONDITIONS) OF TITLE, DESCRIPTION AND QUALITY AND THE EFFECTIVENESS OF DISCLAIMER CLAUSES

In every contract of sale, unless otherwise agreed, certain terms relating to the seller's obligations with respect to the title, description and quality of the goods are implied by virtue of sections 13 to 16 of *The Sale of Goods Act*. In our *Report on Consumer Warranties and Guarantees*,¹ we expressed the view that, on the whole, these provisions have worked well from the consumer's point of view. It seemed to the Commission that the major difficulties arose, not from any defects from which they suffer, as undoubtedly they do to some extent, but from the seller's disposition to exclude or restrict the implied terms so as to deprive the buyer of the benefit of these statutory provisions. However, the *Warranties Report* concluded that the existing provisions were in need of some clarification and modernization, and we made a substantial number of recommendations² with this object in view.

We have reached substantially the same conclusion both with respect to the operation of the implied obligations in non-consumer sales, and with respect to the desirability of adopting similar amendments in a sales Act of general application. Since the publication of the *Warranties Report*, the U.K. Parliament has adopted the *Supply of Goods (Implied Terms) Act 1973*.³ In considering what changes to recommend in the revised Ontario Act, we have had the advantage of being able to study the provisions of this Act, in conjunction with the corresponding provisions of Article 2 of the *Uniform Commercial Code*. The changes that we recommend are considered below.

1. TITLE, QUIET POSSESSION, AND FREEDOM FROM ENCUMBRANCES

Section 13 of the Ontario Sale of Goods Act imposes upon a seller three implied title obligations. Section 13 provides as follows:

13. In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is,

- (a) an implied condition on the part of the seller that in the case of a sale he has a right to sell the goods, and that in the case of an agreement to sell he will have a right to sell the goods at the time when the property is to pass;
- (b) an implied warranty that the buyer will have and enjoy quiet possession of the goods; and

¹Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), pp. 32-33.

²Ibid., pp. 32 *et seq.*

³1973, c. 13 (U.K.).

- (c) an implied warranty that the goods will be free from any charge or encumbrance in favour of any third party, not declared or known to the buyer before or at the time when the contract is made.

We now set out the corresponding provisions in section 12 of the U.K. Act, as amended by the Act of 1973, and in UCC 2-312. Section 12 of the amended U.K. Act provides as follows:

12.(1) In every contract of sale, other than one to which subsection (2) of this section applies, there is —

- (a) an implied condition on the part of the seller that in the case of a sale, he has a right to sell the goods, and in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass; and
- (b) an implied warranty that the goods are free, and will remain free until the time when the property is to pass, from any charge or encumbrance not disclosed or known to the buyer before the contract is made and that the buyer will enjoy quiet possession of the goods except so far as it may be disturbed by the owner or other person entitled to the benefit of any charge or encumbrance so disclosed or known.

(2) In a contract of sale, in the case of which there appears from the contract or is to be inferred from the circumstances of the contract an intention that the seller should transfer only such title as he or a third person may have, there is —

- (a) an implied warranty that all charges or encumbrances known to the seller and not known to the buyer have been disclosed to the buyer before the contract is made; and
- (b) an implied warranty that neither —
 - (i) the seller; nor
 - (ii) in a case where the parties to the contract intend that the seller should transfer only such title as a third person may have, that person; nor
 - (iii) anyone claiming through or under the seller or that third person otherwise than under a charge or encumbrance disclosed or known to the buyer before the contract is made;

will disturb the buyer's quiet possession of the goods.

Section 2-312 of the *Uniform Commercial Code* reads as follows:

2-312.(1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that

- (a) the title conveyed shall be good, and its transfer rightful; and
- (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

In our view, the conditions and warranties implied by section 13 of the Ontario Sale of Goods Act are generally satisfactory. However, the section gives rise to a number of difficulties, and raises several issues of policy. We recommend that the terms implied by section 13 should be retained in the revised Act, subject to appropriate changes and modifications to resolve these matters. We turn now to a discussion of the problems raised by section 13.

(a) THE IMPLIED CONDITION OF TITLE: SECTION 13(a)

It seems anomalous that the Act should characterize the implied term with respect to the seller's title as a condition, whereas the implied terms of quiet possession and freedom from encumbrances are only treated as warranties. The assumption appears to be that a breach of the latter terms will be substantially less prejudicial to the buyer than a breach involving his title. This may be true in many cases, but it is by no means universally true. We need not pursue this point, because the elimination of the distinction between warranties and conditions, which we have previously recommended,⁴ and the adoption of a new remedial regime based on the concept of substantial breach, will result automatically in the uniform treatment of the three implied terms.

Another difficulty about subsection (a) is that it does not provide adequate protection in the case of a conditional sale in which the buyer obtains immediate possession of the goods, but in which transfer of title is deferred to a future date. A literal application of the subsection would lead to the conclusion that, until he has discharged all his obligations under the security agreement, the buyer is not entitled to complain about a defect in the seller's title. This would be a manifestly unsatisfactory result. As was noted in our *Warranties Report*,⁵ the English courts have bridged this gap in the case of hire-purchase agreements by implying a term at common law that the owner has title at the time he delivers the goods to the hirer.⁶ Although the point does not appear to have been

⁴Supra, ch. 6, sec. B.

⁵Supra, footnote 1, p. 33.

⁶Karflex Ltd. v. Poole, [1933] 2 K.B. 251; Warman v. Southern Counties Car Finance Corp. Ltd., [1949] 2 K.B. 576. Quaere whether these cases remain good law even though the successive U.K. Hire Purchase Acts and, now, the Supply of Goods (Implied Terms) Act 1973, c. 13 (U.K.), s. 8 as amended, implied or imply statutory terms as to the owner's title?

raised directly,⁷ presumably the same reasoning would be applied to a conditional sale agreement. An alternative, and, in our view, preferable, approach would be for the court to find that the beneficial property in the goods is intended to pass to the buyer upon delivery of the goods, and that the seller's title is only by way of security. This is the theory clearly adopted in Articles 2 and 9 of the Code, and in *The Personal Property Security Act*. We have also adopted it in the Draft Bill.⁸ However, it may be desirable to spell out specifically the implications of this characterization in the context of the seller's implied warranty of title. Accordingly, we recommend the insertion of a new provision in the revised Act to the effect that, where the seller retains a security interest in the goods, his implied warranty of title takes effect when the goods are delivered to the buyer.⁹

A more controversial point concerns the requirement in subsection (a), that the seller must have a "right" to sell the goods; a "power" to pass a good title will not suffice to satisfy the condition. Suppose a dealer who has pledged his inventory sells parts of it in violation of the terms of the security agreement. He has no "right" to sell the goods, but section 30(1) of *The Personal Property Security Act*¹⁰ gives him a "power" to pass a better title than he himself has. In these circumstances, should the seller be able to resist a claim by the buyer under subsection (a)? Our view is that he should not. We consider that provisions such as section 30 of *The Personal Property Security Act* are intended to protect innocent buyers, and not to provide a shield for erring sellers. We would adopt the same position whether or not the seller has acted in good faith, on the ground that the buyer has not bargained for a lawsuit. We do not, therefore, recommend any change in this aspect of subsection (a).

(b) IMPLIED WARRANTY OF QUIET POSSESSION

An important question concerning the scope of the implied warranty of quiet possession arose in *Microbeads A.G. v. Vinhurst Road Markings Ltd.*¹¹ This case concerned, *inter alia*, a counterclaim by a buyer of goods for breach of the implied warranty of quiet possession. The counterclaim related to an action that had been brought against the buyer by a patentee for infringement of patent rights that had crystallized after delivery of the goods to the buyer. The English Court of Appeal held that the warranty of quiet possession does not operate to protect a buyer only in respect of acts committed by the seller, or otherwise arising, before the goods were delivered to the buyer. The Court held that the warranty of quiet possession had equal application to acts leading to a lawful interference with the buyer's quiet possession that arose after this date. The New South

⁷It was not raised, for example, in *Sloan v. Empire Motors Ltd.* (1956), 3 D.L.R. (2d) 53 (B.C.C.A.).

⁸See, for example, Draft Bill, s. 6.1(2)(b).

⁹See, Draft Bill, s. 5.12(3).

¹⁰R.S.O. 1970, c. 344 as am. Section 30(1) provides as follows:

30.(1) A purchaser of goods from a seller who sells the goods in the ordinary course of business takes them free from any security interest therein given by his seller even though it is perfected and the purchaser actually knows of it.

¹¹[1975] 1 W.L.R. 218, [1975] 1 All E.R. 529 (C.A.).

Wales *Working Paper on the Sale of Goods*¹² apparently takes the position that this decision imposes too heavy a burden on the seller. The Working Paper has recommended an amendment¹³ to the New South Wales *Sale of Goods Act* to restrict the seller's liability to lawful claims existing at the time of sale or delivery of the goods. We appreciate the difficult position in which the Court's interpretation of the warranty of quiet possession in the *Microbeads* case could place the seller. But we agree with Lord Denning¹⁴ that, as between two innocent parties (assuming that the seller is, in fact, innocent) it is a just result that the seller should absorb any loss because, "after all, he sold the goods". It seems to us that the seller's position in this case is no different than in any other case in which the goods suffer from a hidden defect of which the seller was not aware, and which he could not have discovered through the exercise of reasonable care. We do not, therefore, recommend any change in subsection (b).

We do not, however, wish to be misunderstood. The *Microbeads* case involved an unusual set of facts, in which the third party had at least an inchoate claim at the time the goods were delivered to the buyer. This case does not go so far as to hold that any post-delivery interference with the buyer's possession (for example, an embargo on the possession of firearms) will involve a breach of the warranty of quiet possession. In particular fact situations, it may well be that this question will be subject to future judicial development.

(c) IMPLIED WARRANTY OF FREEDOM FROM ENCUMBRANCES

We deal here with three questions. The first is whether, having regard to the implied warranty of quiet possession, subsection (c) is needed at all. The second question involves the meaning of the words "charge" or "encumbrance", as these words appear in section 13(c). The third question we discuss concerns the point of time from which the implied warranty of freedom from encumbrances begins to run.

We now turn to the first question: namely, whether subsection (c) is needed at all, given the fact that it is difficult to envisage undisclosed charges or encumbrances against the goods that will not also, sooner or later, involve an interference with the buyer's quiet possession. Although this may be true, the subsection does no harm, and may still serve a useful residual purpose. In our opinion, therefore, it should be retained.

The second question, as we have noted, involves the meaning of "charge" and "encumbrance" as these words appear in section 13(c). These terms are not defined in the Act, but presumably Chalmers meant them to carry the same meaning as they carry in land law from where, it has been surmised,¹⁵ he borrowed the concept of freedom from encumbrances. The absence of a definition does not appear to have given rise to difficulties in practice, and we do not suggest that one should be adopted

¹²Law Reform Commission, New South Wales, *Working Paper on the Sale of Goods* (1975), para. 12.10.

¹³Ibid., and New South Wales Draft Bill, s. 20E(4).

¹⁴[1975] 1 W.L.R. 218, at p. 223, [1975] 1 All E.R. 529, at p. 533.

¹⁵Compare, *Benjamin's Sale of Goods* (1974), para. 277, n. 82.

now. We recommend, however, the addition of the term "security interest", which also appears in UCC 2-312(1)(b), and we do so for two reasons. The first reason is that the term is a familiar one to commercial lawyers, and its addition will resolve any lingering doubts with respect to the applicability of subsection (c) to consensual *in rem* rights against the goods. The second reason is that it will help to emphasize, once again, that a prior seller's reservation of title under an instalment sale is to be classified as a security interest, and therefore as falling within subsection (c).

The third question is concerned with the point in time from which the implied warranty of freedom from encumbrances begins to run. Subsection (c) is ambiguous in this respect. The subsection refers to an implied warranty that the goods "will be free" from any charge or encumbrance. The use of the future tense suggests, at any rate, that the implied warranty begins to run at some point subsequent to the formation of the contract of sale. Section 12(1)(b) of the amended U.K. Act now provides that there is an implied warranty "that the goods *are* free, and will remain free until the time when the property is to pass" from any undisclosed charge or encumbrance. This clearly changes the prior law. The use of the present tense, "are free", indicates that the warranty begins to run immediately. This, as Benjamin points out,¹⁶ could lead to some curious results, since the goods may be unascertained, in the ownership of some third party, or even not in existence at the time of the agreement to sell. We do not, therefore, recommend adoption of the U.K. amendment. We prefer, instead, the formulation in UCC 2-312(1)(b) that the goods "shall be delivered" free from any security interest or the like and recommend the adoption of a similar provision in the revised Act.¹⁷ This formulation captures accurately the interests that the warranty of freedom from encumbrances seeks to protect.

(d) IMPLIED WARRANTY OF ABSENCE OF INFRINGEMENTS

UCC 2-312(3), dealing with questions of patent infringement and the like, has no counterpart in section 13 of the Ontario Act or in section 12 of the amended U.K. Act. As will have been noted, the Code provision addresses itself to the type of problem that arose in the *Microbeads* case. UCC 2-312(3) implies a warranty on the part of a "merchant regularly dealing in goods of the kind" that the goods will be delivered free of the rightful claim of any third person "by way of infringement or the like".¹⁸ The section does not deem a private seller to warrant the goods free of patent infringement or the like. The Comment to the Code provision¹⁹ justifies this distinction on the ground that, when the goods are part of the seller's normal stock and sold in his normal course of business, it is his duty to see that no claim of infringement of a patent or trademark by a third party will mar the buyer's title; a sale by a person other than a dealer, on the other hand, raises no implication of such a warranty. There is some

¹⁶Ibid., para. 277, p. 140.

¹⁷See, Draft Bill, s. 5.12(1)(b).

¹⁸The draft UNCITRAL Convention (1977 version), Art. 25(1), contains a provision still more favourable to the seller.

¹⁹See, UCC 2-312, Comment 3.

force in this reasoning, but it could just as easily be applied to other components of the implied warranty of title. Since it has not been so applied, and since the problem is apparently one of first impression in Ontario,²⁰ we do not at this time recommend that the revised Act should contain a special provision relating to patent infringements and the like and restricted to merchant sellers. Claims of this type will, therefore, regardless of the character of the seller, continue to be governed by the warranty of quiet possession as well as, in appropriate circumstances, by the warranties of title and freedom from encumbrances.

(e) SELLER'S RIGHT TO CURE DEFECTIVE TITLE AND BUYER'S RIGHT TO RECOVER PAYMENTS ON RESCISSION FOR BREACH OF WARRANTY OF TITLE

It will be convenient to postpone discussion of these issues to chapter 17, which deals with buyer's remedies.

(f) DISCLAIMER OF TITLE OBLIGATIONS IMPLIED BY SECTION 13

Before the adoption of the amendments to the U.K. Act in 1973, there was controversy among academic writers²¹ with respect to whether a seller could successfully exclude his title obligations under section 12 of the U.K. Act, the equivalent of section 13 of the Ontario Act. Those who argued that he could not, pointed to the definition of contract of sale in the Act. They reasoned that a person who, with the one hand, agrees to transfer the general property in the goods cannot negate his undertaking to do so with the other. Other scholars pointed to the opening words of section 12, as well as to the history of the implied condition of title at common law. They argued that Parliament clearly contemplated the possibility that the implied obligation could be excluded, whether by force of circumstances or because of an express disclaimer. Whoever was right, it was

²⁰The *Patents Act*, R.S.C. 1970, c. P-4, provides that any person who infringes a patent is liable to the patentee in damages (s. 57), and that an injunction may issue to enjoin "further use, manufacture or sale" of the infringing goods (s. 59). The Act does not distinguish between different types of infringers; nor does it define infringement. However, an authoritative Canadian text defines infringement as any act that interferes with the full enjoyment of the monopoly granted to the patentee if done without his consent: Fox, *Canadian Patent Law and Practice*, (4th ed., 1969), p. 349. Infringement may occur through the manufacture, use, or, it would appear, mere possession of the patented article, where there is present the intention of user to the detriment of the patentee. An intention to infringe is not material; nor need it be shown that the infringer has derived any pecuniary benefit from his infringement: Fox, *supra*, pp. 381-84. From the foregoing principles, it will be seen that the buyer in a private purchase runs a considerable risk of being sued successfully if the goods infringe a third party's patent, and that the implied warranty of quiet possession serves a necessary purpose to protect him against such a contingency.

²¹See, for example, Hudson, "The Condition as to Title in Sale of Goods" (1957), 20 Mod. L. Rev. 236; Hudson, "The Exclusion of Section 12(1) of the Sale of Goods Act" (1961), 24 Mod. L. Rev. 690; Cheshire & Fifoot, *The Law of Contract* (5th ed., 1960), p. 136; Reynolds, "Warranty, Condition and Fundamental Term" (1963), 79 L.Q.R. 534, 542; Diamond, "Law Reform Committee: Twelfth Report on the Transfer of Title to Chattels" (1966), 29 Mod. L. Rev. 413.

clearly desirable that the position should be clarified. The English and Scottish Law Commissions, in their *First Report on Exemption Clauses in Contracts*,²² thought that the gateway, provided by the opening words of section 12²³ and the general provisions in section 55 of the U.K. Act dealing with exclusion of the implied terms and conditions, clearly permitted the disclaimer of implied obligations, and, indeed, that they were too widely drawn. The Law Commissions saw no justification for excluding or varying the implied condition and warranties imposed by section 12, "save where it is clear that the seller is purporting to sell only a limited title".²⁴ Even in transactions involving limited titles, the Commissions were of the opinion that the seller should not be allowed to exclude entirely the warranties of quiet possession and freedom from encumbrances. The Commissions' recommendations were implemented in the U.K. *Supply of Goods (Implied Terms) Act 1973* by the addition of subsection (2) to section 12 of the *Sale of Goods Act*, and by the insertion of a new subsection (3) in section 55 of the Act.²⁵ The former provision has already been quoted; the latter avoids disclaimer clauses involving the seller's obligations under section 12.

We recommend the inclusion in the revised Ontario Act of a provision comparable to section 12(2) of the U.K. Act.²⁶ We do not, however, favour the statutory entrenchment of the seller's title obligations; accordingly, we recommend that the revised Act should not adopt a provision, similar to section 55(3) of the U.K. Act, prohibiting the disclaimer of the seller's implied title obligations under section 13 of the existing Act. As will be seen hereafter, in non-consumer sales our general position is that disclaimer clauses should be permitted to exclude or vary the seller's implied warranties, subject to an overriding test of unconscionability. We see no justification for making an exception to this rule in the case of the seller's title obligations. In any event, it should be noted that the recommendations of the English and Scottish Law Commissions are not as far reaching as may appear at first sight. It is true that section 55(3) of the U.K. Act applies equally to sections 12(1) and (2) of that Act. The Law Commissions' recommendations, however, accepted the seller's right to exclude his warranty of title where "it is clear" that he is only purporting to sell a limited title, and this right is recognized, although not in identical langu-

²²Law Com. No. 24, Scot. Law Com. No. 12, *Exemption Clauses in Contracts, First Report: Amendments to the Sale of Goods Act 1893* (1969), para. 17.

²³Section 13 of the Ontario Sale of Goods Act. The words are, "unless the circumstances of the contract are such as to show a different intention".

²⁴Supra, footnote 22. The Report does not explain the meaning of "when it is clear". Presumably a disclaimer clause in a standard form agreement would not meet the test; it would be otherwise if, to the knowledge of the buyer, the seller were a trustee in bankruptcy, a sheriff, or other person acting in a special capacity in disposing of the goods. Note, too, that the actual language of section 12(2) does not literally implement the Commissions' recommendation, since it contains no requirement that it must be "clear" that the seller is only offering a limited title. The test is, rather, whether an intention "appears" from the contract or is to be "inferred" from the circumstances that the seller is only obligated to transfer a limited title.

²⁵S. 55(3) has now been repealed and re-enacted in the *Unfair Contract Terms Act 1977*, c. 50 (U.K.), section 6(1)(a).

²⁶See, Draft Bill, s. 5.12(2)(b).

age,²⁷ in the revised version of section 12(1). Accordingly, in the circumstances, it is only the seller's residual obligations under section 12(2) of the amended U.K. Act that cannot be excluded. The differences between our recommendations and those now implemented in the United Kingdom are relatively modest, and encompass primarily the excludability of the provisions in section 12(2). As we have stated, the issue of excludability of title obligations should be resolved by the test of unconscionability. Applying this test, it is difficult to conceive of situations in which the seller could justify the exclusion of the limited obligations under section 12(2). If, however, he can make out a persuasive case, he should not, in our view, be denied the opportunity to do so. No more so would we deprive the buyer of the possibility of showing that the seller's purported exclusion of his obligations under the Ontario equivalent of section 12(1) was unconscionable, a preclusion that appears to result from a literal reading of the U.K. provisions.

2. THE IMPLIED CONDITION OF DESCRIPTION

Section 14 of *The Sale of Goods Act* provides as follows:

14. Where there is a contract for the sale of goods by description, there is an implied condition that the goods will correspond with the description, and, if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

The corresponding provision in Article 2 of the *Uniform Commercial Code*, section 2-313(1), reads as follows:

2-313.(1) Express warranties by the seller are created as follows:

- (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
- (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
- (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

The role of the concept of description is not limited to section 14. The term is also used in other sections of the Act, and its proper role and meaning are therefore of wider importance. For the moment, however, it will be convenient to confine our attention to this section.

Section 14 raises a number of real or apparent difficulties. First, it seems anomalous to describe the obligation as an *implied* condition when, as is usually the case, the description of the goods forms an express term of the contract. This raises the basic question whether section 14 should be retained at all in the revised Act. Secondly, there may still be some

²⁷See, *supra*, footnote 24.

doubt whether a sale in a supermarket or other type of self-service store constitutes a sale "by description". Thirdly, the extent to which a seller is deemed to adopt labels and other descriptive matter, attached to or accompanying the goods, that originate not from him but from some other person such as the manufacturer or distributor, appears to be unsettled.

(a) ANOMALY AND RETENTION

The English and Scottish Law Commissions, in their *First Report on Exemption Clauses in Contracts*, admitted the first incongruity²⁸ but felt it was harmless and served the useful purpose of making it clear that the term amounts to a condition or essential term of the contract, and not a mere warranty. These Commissions, therefore, recommended no change in the section from this point of view.

One member of our Research Team has suggested that this anomaly should be rectified by deleting the section altogether.²⁹ Other members of the Research Team support this position, albeit on different grounds. Two principal points have been made to us. The first is that section 14 is tautological, and that it is not obvious why the Act should single out one type of express term for special attention. The second, and more important, point is that section 14 is grounded upon the basic but, for warranty purposes, now irrelevant, distinction that was drawn in the 19th century between a sale of specific goods and a sale of future or unascertained goods. A sale by description was usually associated with a sale of the latter type. It has, however, been clear, at least since the decision of the Privy Council in *Grant v. Australian Knitting Mills*,³⁰ that a sale of specific goods can also be a sale by description. So far as the U.K. is concerned, the distinction between a sale of specific and other goods has been further eroded by the repeal of part of section 11(1)(c) of the U.K. Act.³¹ As will be seen, the effect of other recommendations in this Report is to eliminate any remaining distinctions between a sale of specific goods and a sale of future or unascertained goods. Hence, it has been argued, there is no longer any need for a provision similar to section 14.

We are not completely persuaded by either line of reasoning. Since we have earlier recommended the elimination of the distinction between warranties and conditions, the office envisaged by the Law Commissions for section 14 will obviously disappear. On the other hand, we are not satisfied that section 14 is of only historical interest. It does seem to us useful that the revised Act should continue the thrust of section 14, and should make it clear, as it is made clear in UCC 2-313(1)(b), that a description of the goods creates an express warranty that the goods con-

²⁸Supra, footnote 22, para. 22.

²⁹See, Waddams, "Implied Conditions and Warranties in The Sale of Goods Act, sections 13 to 16", Research Paper No. III.3, p. 13.

³⁰[1936] A.C. 85 (P.C.).

³¹That is, that part of s. 11(1)(c) depriving the buyer, in a contract for the sale of specific goods the property in which had passed to the buyer, of the right to reject the goods for breach of condition. See the *Misrepresentation Act 1967*, c. 7 (U.K.), s. 4(1). Section 11(1)(c) corresponds to s. 12(3) of the Ontario Act; the U.K. amendment has not been copied in Ontario.

form to the description. Such a description would constitute a part of the contract, without the buyer having to show any particular reliance on the descriptive terms or, if one prefers to use the language of offer and acceptance, that he intended to accept the offer implicit in the seller's terms. However, some minor changes to section 14 would appear to us to be desirable, and we recommend the insertion of the following provision in the revised Act:³²

Without restricting the generality of section 5.10,³³

- (a) in a contract of sale there is an express warranty that the goods to be supplied will conform to their description in the contract; and
- (b) in a contract of sale by sample or model there is an express warranty that the goods to be supplied will conform to their description in the contract and to the sample or model in all respects including quality.

It will be noted that subsection (b) deals with a sale by sample or model and provides, not only that the goods supplied must conform to the description in the contract, but also that they must conform to the sample or model. This latter aspect of the draft subsection incorporates a provision now contained in section 16(2)(a) of the Ontario Sale of Goods Act. As is mentioned below in our discussion of sale by sample,³⁴ we have considered it convenient to incorporate this provision in subsection (b) of our provision dealing with the warranty of description.

(b) SALES IN SELF-SERVICE STORES

The second question that arises in connection with the implied condition of description concerns sales in self-service stores. As noted, there may still be some doubt as to whether such a sale is a sale "by description". The English and Scottish Law Commissions recommended³⁵ that this problem should be resolved by adding a new subsection to section 13 of the U.K. *Sale of Goods Act*, the provision equivalent to section 14 of the Ontario Act. This has now been done. The new clause provides as follows:

13.(2) A sale of goods shall not be prevented from being a sale by description by reason only that, being exposed for sale or hire, they are selected by the buyer.

A similar, but enlarged, recommendation appears in the New South Wales Working Paper.³⁶ The problem to which the U.K. amendment is addressed arises because of earlier doubts as to whether the seller in a self-service store warrants the merchantable quality of his goods. These doubts were raised in part because section 15.2 of the existing Act only applies where goods are bought "by description". Later in this chapter, we recommend

³²See, Draft Bill, s. 5.11(1).

³³The opening line is a reference to the section of the Draft Bill defining express warranty.

³⁴See, *infra*, this ch., sec. 4.

³⁵Supra, footnote 22, para. 24.

³⁶Supra, footnote 12, para. 10.11, and New South Wales Draft Bill, s. 16(1).

deletion of this phrase in section 15.2, with the result that this particular problem will cease to exist. It is also probable that a court today would have little hesitation in holding that a sale, at least of labelled goods, in a self-service store is a sale by description; as an earlier American court remarked about such a sale,³⁷ "the printed word [is] the silent salesman". Nevertheless, to resolve any lingering doubts, we recommend the adoption of a provision comparable to section 13(2) of the U.K. Act in the revised Ontario Act.³⁸

(c) SELLER'S LIABILITY FOR DESCRIPTION OF GOODS BY THIRD PARTY

The problem of deemed adoption by the seller of the labelling and other descriptive materials originating from a third party and attached to or accompanying the goods, is more troublesome. This problem was not considered in the Report of the English and Scottish Law Commissions. As we pointed out in our *Warranties Report*,³⁹ there is a striking dearth of authority on this point, and some clarification would appear to be desirable. In our view, the general proposition should be that a description of the goods given by a third person is binding on the seller only if by his words or conduct he has adopted the description as his own. The Commission recommends the insertion in the revised Act of a provision to this effect.⁴⁰

This recommendation, however, still leaves at large the question whether a different rule should be applied in the case of merchant sellers; for example, should a merchant seller be deemed to adopt the representations made by a manufacturer, whether by labelling or otherwise? The *Warranties Report*⁴¹ favoured the imposition of some additional obligations in the context of consumer sales; we reasoned that there was no greater hardship in holding a retailer responsible for the manufacturer's labelling, than there was in holding him responsible for the merchantability and fitness of goods manufactured by others. It appears to us that this reasoning is also sound in the case of non-consumer sales. It is to be understood that the purpose of such a deemed adoption is not to penalize the merchant seller but, rather, to provide the buyer with some readily accessible means of redress if the labelling turns out to be inaccurate. The seller would, of course, have his usual rights of indemnity against the manufacturer or other person from whom he had acquired the goods.

As previously indicated,⁴² we would not go as far as section 7(2) of Bill 110, *The Consumer Products Warranties Bill, 1976*,⁴³ in holding the retailer jointly liable with the manufacturer for any express warranty given in writing or published by the manufacturer. With section 7(2) of Bill

³⁷*Corvan N. Sams v. Ezy-Way Foodliner Co.* (1961), 170 A. 2d 160 (Me. Sup. Ct.). See, also, *Great Atlantic & Pacific Tea Co. v. Walker* (1937), 104 S.W. 2d 627 (Tex. Civ. App.), 634.

³⁸See, Draft Bill, s. 5.11(2).

³⁹*Supra*, footnote 1, pp. 34-39.

⁴⁰See, Draft Bill, s. 5.11(3).

⁴¹*Supra*, footnote 1, p. 35.

⁴²*Supra*, ch. 6, sec. A.2(d).

⁴³Bill 110, 3rd Sess. 30th Legislature. This Bill was not enacted.

110 may be contrasted section 2-314(2)(f) of the Code. This section provides as follows:

- 2-314.(2) Goods to be merchantable must be at least such as . . .
 (f) conform to the promises or affirmations of fact made on the container or label if any.

This provision seems to us to strike a reasonable balance between providing no guidance as to what types of representations the merchant-seller is deemed to adopt as his own, and holding him responsible for everything the manufacturer may say.⁴⁴ Subject to the modification discussed below, the Commission recommends adoption of a similar provision in the revised Act.⁴⁵ We are also attracted by the Code's perception that the merchant-seller's responsibility for accurate labelling forms part of a reasonable interpretation of merchantable quality, quite apart from the question whether the contents of the labels form part of the seller's express warranties. Accordingly, the Draft Bill also deals with the merchant seller's additional obligations with respect to representations made by third parties as part of the warranty of merchantability. We would, however, recommend a modification to the Code provision. In our view, the equivalent provision in the revised Ontario Act should be enlarged slightly so as to encompass representations or promises on other material accompanying the goods, as well as those appearing on the "container or label".⁴⁶

It remains to be considered whether the word "description" itself needs to be defined. We recommend against a definition. The concept of "description" is a difficult concept, and one that over the years has occasioned much difference of opinion among courts and commentators.⁴⁷ To some, the term should be confined to those elements essential to the identification of the subject matter of the contract; to others, it is broad enough to encompass a variety of attributes not restricted to identification, which, of itself, is an elusive concept. Yet another group of decisions would link the meaning to the context in which the question arises for decision.⁴⁸ Given its variant meaning, the better part of wisdom would appear to be to avoid the term whenever possible. The English and Scottish Law Commissions accomplished this objective, in part, by recommending⁴⁹ the dele-

⁴⁴We assume that this Code provision covers the labelling of third parties, as well as the seller's own labelling. The distinction does not appear to be discussed in the Comments accompanying UCC 2-314, nor in the few cases on subsection (2)(f). See, for example, *Reddick v. White Consolidated Industries Inc.* (1969), 295 F. Supp. 243 (Ga. Dist. Ct.); *Carnes Construction Co. v. Richards & Conover Steel & Supply Co.* (1972), 10 U.C.C. Rep. 797 (Okl. Ct. App.).

⁴⁵See, Draft Bill, s. 5.13(1)(b)(v).

⁴⁶*Ibid.* The need for the extension is illustrated by the *Reddick* case, footnote 44 *supra*, in which the buyer complained about inadequate instructions in the manual supplied by the seller-manufacturer of a gas heater.

⁴⁷See, *inter alia*, the discussion in *Benjamin's Sale of Goods* (1974), paras. 764-80; and *Williston on Sales* (Rev. ed., 1948), secs. 224-25, and the authorities there cited.

⁴⁸See, for example, *Henry Kendall & Sons v. William Lillico & Sons, Ltd.*, [1969] 2 A.C. 31 (H.L.); *Christopher Hill, Ltd. v. Ashington Piggeries, Ltd.*, [1972] A.C. 441 (H.L.).

⁴⁹*Supra*, footnote 22, at pp. 48-49.

tion of the term in the implied conditions of merchantability and fitness. This recommendation has now been implemented in the *Supply of Goods (Implied Terms) Act 1973*.⁵⁰ Article 2 also avoids the use of the term in the corresponding Code sections, UCC 2-314 and 2-315, and in other contexts⁵¹ by-passes the semantic difficulty by adopting the concept of "non-conforming goods". This Commission has also sought to avoid use of the term wherever possible⁵² and recommends a similar approach in the revised Ontario Act.

3. THE IMPLIED CONDITIONS OF QUALITY AND FITNESS

(a) GENERAL CONSIDERATIONS

Section 15 of *The Sale of Goods Act* concerns itself with two implied terms of major importance: namely, those of merchantability and of fitness for purpose. Section 15 provides in part as follows:

15. Subject to this Act and any statute in that behalf, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, except as follows:

1. Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description that it is in the course of the seller's business to supply (whether he is the manufacturer or not), there is an implied condition that the goods will be reasonably fit for such purpose, but in the case of a contract for the sale of a specified article under its patent or other trade name there is no implied condition as to its fitness for any particular purpose.
2. Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or not), there is an implied condition that the goods will be of merchantable quality, but if the buyer has examined the goods, there is no implied condition as regards defects that such examination ought to have revealed.

Three questions arise for general consideration. The first question is concerned with the preamble to section 15. The second question asks whether any changes should be made to the balance of the section. The third question is whether section 15 should be extended to private sales. Before turning to a discussion of these questions, we pause to note that it follows from our earlier recommendation that the implied terms of merchantability and fitness should be designated as warranties in the revised Act.

⁵⁰1973, c. 13, s. 2 (U.K.).

⁵¹For example, UCC 2-601.

⁵²For example, we recommend, *infra*, deletion of the words "by description" in the provision dealing with the implied warranty of merchantability.

It seems anomalous to us that the preamble to section 15 should still appear to convey the impression that the implied terms are exceptions to the *caveat emptor* rule, and not the other way around. Generally speaking, unless successfully excluded, one or other of the two terms, and frequently both, will apply where the seller is a merchant with respect to the goods, and the great majority of sales are made by professional sellers. The preamble has not been reproduced in the Code and, in our view, it no longer serves a useful purpose. We therefore recommend that the preamble to section 15 should not be reproduced in the revised Act, and that the implied warranties should be expressed in positive terms.

The next question to which we turn is whether any basic change should be made in the balance of the section. As is well known, the implied conditions of merchantability and fitness frequently overlap, and it might be thought that one or other is redundant. Such overlapping does not, however, occur in all cases, and will not occur even if the changes recommended below are implemented. We recommend retention of both implied terms. However, it does seem anomalous that the condition of fitness should appear before the condition of merchantability, and we recommend that the order be reversed.

Section 15 only applies to merchant sellers, and the last question is whether either of the implied warranties should be extended to private sellers. The traditional justifications for the restriction to merchant sellers are threefold: namely, that a merchant seller holds himself out as possessing special skill and knowledge with respect to the goods; that he sells for profit; and, that he is in a better position to absorb, or to pass on, any loss resulting from undiscoverable defects than the average buyer. None of these considerations applies to a non-merchant seller. We accept the continuing validity of this reasoning, and do not recommend that the implied terms of merchantability and fitness be extended to private sales. This recommendation does not, however, resolve the question whether a private seller should at least be under an obligation to disclose defects in the goods that are actually known to him, and that are not obvious from a visual inspection of the goods. The question does not lend itself readily to statutory resolution and is, in our view, best left for judicial development by means of the doctrines of good faith and fair dealing, mistake, and constructive fraud.⁵³

⁵³American developments in this area are instructive. Generally, American courts have been unwilling to imply warranties as such in the sale of goods, usually used goods, by private sellers. See, for example, *Keating v. DeArment* (1967), 193 So. 2d 694 (Fla. Dist. Ct. App.). However, the courts may take a different attitude where the seller knew of the defect and failed to disclose it. In the real property sector, an increasing number of American courts are showing a willingness to impose liability on private sellers for such non-disclosure on a theory of fraudulent concealment. See, for example, *Obde v. Schlemeyer* (1960), 353 P. 2d 672 (Wash. Sup. Ct.); and compare, *Carlish v. Salt*, [1906] 1 Ch. 335. Other, generally earlier, courts have taken a narrower viewpoint: *Swinton v. Whitinsville Savings Bank* (1942), 42 N.E. 2d 808 (Mass. S.C.); and compare, *Scott-Polson v. Hope* (1958), 14 D.L.R. (2d) 333 (B.C.S.C.). See, further, Goldfarb, "Fraud and Non-Disclosure in the Vendor-Purchaser Relation" (1956), 8 W. Res. L. Rev. 5; and Haskell, "The Case for an Implied Warranty of Quality in Sales of Real Property" (1964-65), 53 Geo. L.J. 633, at pp. 642-43.

(b) THE IMPLIED CONDITION OF MERCHANTABILITY

It will be convenient to set out, once again, section 15.2 of the Ontario Sale of Goods Act. The section provides as follows:

15.2. Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or not), there is an implied condition that the goods will be of merchantable quality, but if the buyer has examined the goods, there is no implied condition as regards defects that such examination ought to have revealed.

The *Warranties Report*⁵⁴ drew attention to a substantial number of respects in which the existing section is ambiguous or defective, and made appropriate recommendations for change. Some of the changes were also recommended by the English and Scottish Law Commissions and have now been implemented in the U.K. *Supply of Goods (Implied Terms) Act 1973*. As a result, the revised section in the U.K. *Sale of Goods Act* reads:

14.(2) Where the seller sells goods in the course of a business, there is an implied condition that the goods supplied under the contract are of merchantable quality, except that there is no such condition

- (a) as regards defects specifically drawn to the buyer's attention before the contract is made; or
- (b) if the buyer examines the goods before the contract is made, as regards defects which that examination ought to reveal.

The amended Act also contains the following definition of merchantable quality:

62.(1A) Goods of any kind are of merchantable quality within the meaning of this Act if they are as fit for the purpose or purposes for which goods of that kind are commonly bought as it is reasonable to expect having regard to any description applied to them, the price (if relevant) and all the other relevant circumstances; and any reference in this Act to unmerchantable goods shall be construed accordingly.

Subject to the exceptions noted hereafter, we support the U.K. changes. There are, however, a substantial number of points that also require consideration, and to these we now turn our attention.

(i) *Sale "By Description"*

Under section 15.2, the implied warranty only applies where the goods are bought "by description". There is no reference to this requirement in the amended U.K. section dealing with the implied condition of merchantable quality. As previously indicated, we support the elimination of the requirement of a sale by description, and so recommend. We do so on two grounds. First, the courts have deprived the phrase "by description" of most of its meaning in the context of section 15.2, and it would be confusing to retain the phrase. Secondly, for reasons stated, we consider it desirable to avoid the use of the term "description" wherever possible.

⁵⁴Supra, footnote 1, pp. 36 *et seq.*

(ii) *Character of Seller*

Section 15.2 of the Ontario Act not only requires a sale "by description", but also requires that the goods be purchased from a seller "who deals in goods of that description". In the amended U.K. Act, it need only be shown that the seller sold the goods "in the course of a business".⁵⁵ In our view, undesirable results could flow from imposing a condition of merchantability on a business seller, regardless of whether he deals, or has ever purported to deal, in goods of the kind offered for sale. As commentators have noted⁵⁶ a literal reading of the U.K. language would lead, as the Law Commissions apparently intended it to lead,⁵⁷ to liability attaching to a seller who was disposing of a piece of capital equipment that had become surplus to his requirements; for example, disposition of a truck by a fuel supplier.

If the only result of the British approach were to entitle the buyer to a reduction in the price if the truck turned out to be in poorer condition than the buyer had a right to assume, we could accept it with equanimity. Indeed, a persuasive argument could be made for permitting such an action *in quanti minoris* against any seller.⁵⁸ It seems reasonable to assume, however, that, under the U.K. approach, the seller's liability would encompass the full measure of damages recoverable under the rule in *Hadley v. Baxendale*,⁵⁹ including any consequential damages suffered by the buyer. We do not think this desirable. Accordingly, we recommend that the warranty of merchantability should be restricted in the revised Act to a seller who deals in goods of the kind supplied under the contract of sale. We note that this is the same test as is used in UCC 2-314(1), although the Code employs slightly different language.

(iii) *Sales by an Agent*

The English and Scottish Law Commissions recommended⁶⁰ that, where a sale by a private seller is effected through an agent acting in the course of business, the conditions of merchantable quality and fitness for purpose should be implied, unless reasonable steps have been taken to inform the buyer before the contract is made that the sale is on behalf

⁵⁵Emphasis added.

⁵⁶Benjamin's *Sale of Goods* (1974), para. 788; Law Reform Commission, New South Wales, *Working Paper on the Sale of Goods* (1975), para. 8.7.

⁵⁷First Report on Exemption Clauses in Contracts, footnote 22 *supra*, para. 31, n. 30, and para. 46.

⁵⁸The *actio redhibitoria* and action *in quanti minoris* were permitted in classical Roman law for rescission of the sale or a reduction in the price if the goods suffered from a latent vice unknown to the buyer and which he could not have discovered by reasonable examination before the purchase. The seller's knowledge of the defects was equally immaterial. Apparently the remedies were not restricted to suits against commercial sellers. See Buckland, *A Text-Book of Roman Law from Augustus to Justinian* (3rd ed., 1966), pp. 491 *et seq.* These grounds of relief, seemingly rooted in concepts of unjust enrichment and fair dealing, survive in modern civil law systems. See, for example, Quebec C. Civ., arts. 1522 *et seq.*; and compare, Treitel, "Remedies for Breach of Contract", in *International Encyclopedia of Comparative Law*, Vol. VII, pp. 16-57 to 16-60.

⁵⁹(1854), 9 Exch. 341.

⁶⁰Supra, footnote 22, para. 55.

of a private seller, or unless the buyer was otherwise aware of the fact. This recommendation, too, has been implemented in the *Supply of Goods (Implied Terms) Act 1973*,⁶¹ which added a new section 14(5) to the U.K. *Sale of Goods Act*. After careful consideration, a majority of the Commission⁶² has decided not to follow this recommendation. It appears to us that the equities are fairly evenly divided as between the private seller and the buyer, and that an insufficient case has been made out for changing the existing law. Let us suppose, for example, that a dealer who holds goods on consignment from a non-merchant seller fails to disclose his agency capacity to the buyer. Although, under existing law, the buyer would appear to be unable to sue the undisclosed principal for breach of the warranties of merchantability or fitness, he would still have his remedy against the agent. It would seem less obvious that the principal would have a right of indemnity against the agent for failure to disclose his agency capacity, if the U.K. amendment were adopted, unless a provision to this effect were also added. Again, it would not occur to the average principal that he must instruct his agent to be sure to disclose not only his status as agent, but also the fact that he is acting for a private seller. Moreover, if he did give such instructions, it is not clear whether they would satisfy the requirements of section 14(5) of the U.K. Act that "reasonable steps" must be taken to bring the facts to the notice of the buyer before the contract is made. In the result, the U.K. amendment raises as many difficulties as it purports to resolve. So far as we have been able to ascertain, the existing law has not caused serious practical problems and, in the absence of persuasive evidence to the contrary, we see no sufficient justification for change. Accordingly, we recommend that the revised Act should not contain a provision similar to section 14(5) of the U.K. *Sale of Goods Act*, as amended.

(iv) Meaning of "Merchantable Quality"

(1) General Considerations

The Ontario Sale of Goods Act contains no definition of "merchantable quality". The expression "quality of goods" is defined in section 1(1)(j) as including their state or condition, but this throws little light on the meaning of the term "merchantable". Over the years the term has attracted conflicting judicial interpretations.⁶³ This is not surprising, given its etymological and historical origins and the widely varying contexts in which the question arises for decision.⁶⁴ The meaning of merchantability

⁶¹1973, c. 13 (U.K.), s. 3.

⁶²One of the Commissioners, the Honourable Richard A. Bell, does not concur in this recommendation. In Mr. Bell's opinion, where a private seller retains the services of an agent who acts in the course of his business, and unless the buyer is made aware that the sale is on behalf of a private seller, the buyer is entitled to assume that the sale is being made by the agent himself in the course of his business with all the implied warranties attached to such a sale. He would adopt the recommendations of the English and Scottish Law Commissions and the principle set forth in section 14(5) of the U.K. *Sale of Goods Act* as enacted by the *Supply of Goods (Implied Terms) Act 1973*.

⁶³These interpretations are reviewed in *Henry Kendall & Sons v. William Lillico & Sons Ltd.*, [1969] 2 A.C. 31 (H.L.).

⁶⁴As to which see, generally, Prosser, "The Implied Warranty of Merchantable Quality" (1943), 21 Can. Bar Rev. 446.

was subjected to close scrutiny by the House of Lords in *Henry Kendall & Sons v. William Lillico & Sons Ltd.*,⁶⁵ and a majority of the Law Lords supported,⁶⁶ with or without modification, a test put forward by Dixon, J., in *Australian Knitting Mills Ltd. v. Grant*.⁶⁷ This test was to the following effect:

The condition that goods are of merchantable quality requires that they should be in such an actual state that a buyer fully acquainted with the facts and, therefore, knowing what hidden defects existed, and not being limited to their apparent condition would buy them without abatement of the price . . . and without special terms.

The English and Scottish Law Commissions, in their *Working Paper on Exemption Clauses*,⁶⁸ adopted an amplified version of Dixon, J.'s test.⁶⁹ The Commission, however, abandoned this amplified version in their Report⁷⁰ in favour of the definition of merchantable quality that now appears, with inconsequential changes, in section 62(1A) of the U.K. Act.⁷¹

The reason given for the change was⁷² that the earlier definition had been criticized as being unduly complicated, and that the new definition was more in line with Article 33(1)(d) of the Uniform Law on the International Sale of Goods, and with one of the minimum standards of merchantability adopted in UCC 2-314(2)(c). The Report does not suggest, however, that any difference in result was intended. Benjamin, at least, takes the view that the definition is largely declaratory of the prior case law, which "may be regarded as still relevant".⁷³

However, we understand⁷⁴ that some counsel at the English Bar and

⁶⁵*Supra*, footnote 63.

⁶⁶The approval must now be read in the light of the qualifying remarks in *B. S. Brown & Son Ltd. v. Craiks Ltd.*, [1970] 1 W.L.R. 752, [1970] 1 All E.R. 823 (H.L.), on the relevance of price in determining merchantability.

⁶⁷(1933), 50 C.L.R. 387 (Austr. H.C.), 418, reproduced in *Benjamin's Sale of Goods* (1974), para. 798.

⁶⁸Law Com. W.P. No. 18, Scot. Law Com. Memorandum No. 7, *Provisional Proposals Relating to Amendments to Sections 12-15 of the Sale of Goods Act 1893 and Contracting Out of the Conditions and Warranties Implied by those Sections* (1968).

⁶⁹The Law Commissions' version provided as follows:

'Merchantable quality' means that the goods tendered in performance of the contract shall be of such type and quality and in such condition that having regard to all the circumstances, including the price and description under which the goods are sold, a buyer, with full knowledge of the quality and characteristics of the goods, including knowledge of any defects, would, acting reasonably, accept the goods in performance of the contract.

See, *Exemption Clauses in Contracts, First Report*, footnote 22 *supra*, p. 16, n. 46.

⁷⁰*Supra*, footnote 22, para. 43.

⁷¹Section 62(1A) is reproduced *supra*, at p. 208.

⁷²*Supra*, footnote 22, para. 43.

⁷³*Benjamin's Sale of Goods* (1974), paras. 801, 794. For a similar view, see Atiyah, *The Sale of Goods* (5th ed., 1975), p. 85. Lord Denning opined in *Cehave N.V. v. Bremer Handelsgesellschaft m.b.H.*, [1975] 3 W.L.R. 447 (C.A.), 457, that the statutory definition was "the best that has yet been devised".

⁷⁴We are indebted to Professor Reuben Hasson of the Osgoode Hall Law School, York University, for drawing our attention to the information that follows.

a number of teachers of commercial law in the United Kingdom adopt a different position. Their view is that, even if inadvertently, section 62(1A) differs from the definition of "merchantable quality" initially adopted in the Law Commissions' Working Paper in one or two respects. First, it is said that, since section 62(1A) speaks of the goods as being "fit for the purpose or purposes" for which goods of that kind are commonly bought, this test excludes cosmetic or other defects which do not interfere with the functional or use value of the goods, but which may reduce their resale value or general acceptability. Hence, it is argued, for example, that a new car that is delivered in a scratched and dirty condition and with other minor defects that do not affect the road-worthiness of the vehicle would satisfy the statutory definition of merchantable quality contained in section 62(1A), even though it might not satisfy the common law test.

In our view, leaving aside all other considerations,⁷⁵ this places an unjustifiably narrow construction on the meaning of "fitness", and also ignores the statutory definition of "quality of goods", which is not restricted to functional characteristics. Nevertheless, we agree that it is desirable to remove the doubt created by the words "fit for the purpose or purposes". Accordingly, with this objective in mind, we recommend that the revised Act should adopt a definition of "merchantable quality", and that this definition, although based on section 62(1A) of the U.K. Act, should include reference to the quality and condition of the goods. Our recommended definition would read as follows:⁷⁶

In this section 'merchantable quality' means

- (a) that the goods, whether new or used, are as fit for the one or more purposes for which goods of that kind are commonly bought *and are of such quality and in such condition* as it is reasonable to expect having regard to any description applied to them, the price, and all other relevant circumstances; (Emphasis added)

It will be observed that we have added the words in italics to make it clear that merchantable quality is not restricted to the functional or use value of the goods. If this amendment is adopted, there no longer appears any need for a separate statutory definition of quality of goods, and none appears in our Draft Bill.

The second point raised by the British observers is that a test of reasonable fitness is not the same as asking whether a reasonable buyer, knowing of the defects from which the goods suffer, would accept the

⁷⁵Including the not unimportant consideration that it is in conflict with earlier decisions in various parts of the Commonwealth: see, for example, *Jackson v. Rotax Motor & Cycle Co., Ltd.*, [1910] 2 K.B. 937 (C.A.); *I.B.M. v. Shcherban*, [1925] 1 D.L.R. 864 (Sask. C.A.); *Winsley v. Woodfield* (1929), 48 N.Z.L.R. 480 (N.Z.S.C.). Some of the reasoning in the *Cehave* case, footnote 73 *supra*, is difficult to reconcile with these and other decisions that were not referred to in the case. The facts however in the *Cehave* case were of a very unusual character, and may have coloured the Court's perception of the meaning of merchantable quality.

⁷⁶See, Draft Bill, s. 5.13(1)(a).

goods in performance of the contract. This point may be illustrated by referring to our earlier example of a new car that is delivered in a dirty and scratched condition. The British observers would suggest that, applying the test of Dixon, J., a reasonable buyer would not accept such a car in performance of the contract. They would also suggest that, as new cars are often delivered in an imperfect condition, such a car would not, on that account, be regarded as unfit for its purpose within the meaning of section 62(1A). We do not find this argument persuasive. First, it suggests that goods are reasonably fit within the meaning of section 62(1A) so long as the defects are commonly encountered and are not too serious in nature. Stated in this bald form, we find it an unattractive proposition. To so construe section 62(1A) places a premium on shoddy workmanship and poor quality control, and puts the buyer completely at the mercy of prevailing industry standards. Secondly, this construction wrongly assumes that a *reasonable* buyer would reject goods that suffer from minor defects, even though he needs the goods, knows that he could not do better by buying them elsewhere and, in the case of durable goods, could anticipate a bona fide effort by the dealer or manufacturer to rectify the defects. We are therefore led to the conclusion that there is no essential distinction in this regard between the test of merchantable quality propounded by Dixon, J., and the definition in section 62(1A), and we see no need for further amendment to this aspect of the U.K. definition.

We have two other reasons for adopting this position. As is explained below, we recommend amplification of the definition of merchantable quality by adding criteria of merchantability drawn from UCC 2-314 and other sources. This should provide greater specificity in doubtful situations. The other, and still more important, reason is that the consequences of a breach of the implied term of merchantable quality differ fundamentally under our proposed remedial regime from the consequences under the U.K. Act. Under that Act, the implied term of merchantable quality is a condition and, once a breach is shown, the buyer is entitled to reject the goods, however minor the defect. This consideration appears to have exerted a substantial influence on the interpretation of the meaning of merchantable quality by British commentators. Under our proposals, an initial right of rejection will only arise for a "substantial" breach and, even then, if certain conditions are satisfied, the seller may still have a right to cure the non-conformity.⁷⁷ In the case of minor defects, the buyer's primary remedy⁷⁸ will lie in a claim for damages. We would therefore anticipate a greater willingness on the part of a court to find a breach of the warranty of merchantability, since the consequences, in the case of minor defects, will not be draconian from the seller's point of view.

⁷⁷See, *supra*, ch. 6, sec. B; and *infra*, ch. 17, sec. C.1(d)(ii); and Draft Bill, ss. 7.7, 8.1.

⁷⁸We refer to "primary", but not exclusive, remedy since, in some circumstances, the buyer may be entitled to reject even for minor breaches where the seller fails to cure the non-conformity when requested to do so. See, Draft Bill, s. 7.7 (4), (5).

(2) "Purpose or Purposes"

The definition of "merchantable quality" in section 62(1A) of the U.K. *Sale of Goods Act* requires goods to be fit for the "purpose or purposes" for which goods of that kind are commonly bought. In *Henry Kendall & Sons v. William Lillico & Sons Ltd.*,⁷⁹ the House of Lords held that goods are merchantable if they are fit for some of the purposes for which the goods are normally used, even though they are unfit for other purposes, equally normal, so long as there are persons who, knowing of the defect, are willing to buy the goods and still pay the same price for them. In our *Warranties Report*⁸⁰ we criticized this test as leading to haphazard and unfortunate results, and urged its statutory reversal, at least for consumer sales. In our view, this criticism is just as apt for non-consumer sales. The definition of merchantable quality that now appears in section 62(1A) of the U.K. Act reverses the rule in *Henry Kendall & Sons v. William Lillico & Sons Ltd.* As indicated, this definition requires the goods to be as fit "for the purpose or purposes" for which goods of that kind are commonly bought as it is reasonable to expect, having regard to the factors listed in the definition. The expanded definition in section 62(1A) has been criticized in the New South Wales Working Paper⁸¹ on the ground of the additional burden it imposes on merchant sellers. For a number of reasons, we do not think this concern is justified. First, the added burden will only be marginal and may, in the case of defective products causing injury to person or property, be expected to be covered by liability insurance. Secondly, the House of Lords has substantially undermined the test in *Henry Kendall & Sons v. William Lillico & Sons Ltd.*, by the expanded interpretation of the warranty of fitness that a majority of the Law Lords adopted in the *Ashington Piggeries* case.⁸² As a result we recommend that, as in the case of section 62(1A) of the amended U.K. *Sale of Goods Act*, the definition of merchantable quality in the revised Act should require goods to be fit for "the one or more purposes for which goods of that kind are commonly bought".⁸³

(3) Used Goods

The English and Scottish Law Commissions clearly assumed that the statutory warranty of merchantability applies to the sale of used, as well as new, goods, and intended the definition of merchantable quality to encompass both types of goods. As the *Warranties Report* pointed out,⁸⁴ the Canadian cases on this point are conflicting. Although the more recent cases⁸⁵ amply support the Law Commissions' assumption, it would, in our

⁷⁹[1969] 2 A.C. 31 (H.L.).

⁸⁰Supra, footnote 1, pp. 39-40.

⁸¹Supra, footnote 12, para. 8.38.

⁸²*Christopher Hill Ltd. v. Ashington Piggeries Ltd.*, [1972] A.C. 441 (H.L.).

⁸³See, Draft Bill, s. 5.13(1)(a).

⁸⁴Supra, footnote 1, p. 39.

⁸⁵See, for example, *Henzel v. Brussels Motors Ltd.*, [1973] 1 O.R. 339, (1973) 31 D.L.R. (3d) 131 (Co. Ct.); *Presley v. MacDonald*, [1963] 1 O.R. 619, (1963), 38 D.L.R. (2d) 237 (Co. Ct.); *Green v. Holiday Chevrolet-Oldsmobile Ltd.*, [1975] 4 W.W.R. 445 (Man. C.A.); compare, *Crowther v. Shannon Motor Co.*, [1975] 1 W.L.R. 30 (C.A.).

view, be helpful to make the position clear in the revised Act. We therefore recommend that the revised Act should provide that the implied warranty of merchantability applies to used, as well as to new, goods.⁸⁶ This does not, of course, mean that a buyer of used goods from a merchant is entitled to expect goods in as merchantable a condition as new goods of the same type could be expected to be; how much he can reasonably expect will depend on "all . . . relevant circumstances".⁸⁷

(4) Durability

The *Warranties Report*⁸⁸ also felt it desirable to clarify the status of the important concept of durability. In our view, intervening developments have fully justified our earlier recommendation that an implied warranty of reasonable durability of the goods supplied should be included in the proposed Consumer Products Warranties Act. This recommendation has, however, encountered strong resistance from various industry groups. Presumably, the same objections would be raised if a durability provision were to be inserted in the revised Sale of Goods Act. The gravamen of the objections⁸⁹ lies in the complaint that "reasonable durability" is an elusive concept, that it has no generally understood meaning, and that the introduction of the concept into sales law would invite a long period of litigation. Despite these criticisms, it appears that at least some manufacturers would support a concept of "minimum" durability, if regulations were available to define the period of durability for particular products.⁹⁰

We sympathize with the manufacturers' apprehensions, but we do not believe that their objections come to grips with the basic problem. As our *Warranties Report* points out,⁹¹ the concept of durability is not new; it is inherent in the concept of merchantability, and there is respectable authority to support the concept. The purpose of our recommendation in the *Warranties Report* was not to innovate, but to clarify. Moreover, it may, indeed, be questioned whether the concept of durability is more uncertain than the concept of merchantability. A concept of minimum durability is helpful in the consumer context, where regulations are a feasible device to provide certainty; but this solution is not likely to be available in a general sales act, which must of necessity encompass an infinite range of goods. For this reason, a concept of minimum durability can do little to dispel uncertainty in the general sales area.

Having regard to these considerations, we believe it is as desirable for

⁸⁶See, Draft Bill, s. 5.13(1)(a).

⁸⁷*Ibid.*

⁸⁸*Supra*, footnote 1, pp. 37-38.

⁸⁹We refer, for example, to a brief submitted to the Ontario Government by the Canadian Manufacturers' Association, in December 1973.

⁹⁰*Ibid.*

⁹¹In addition to the case law cited in the Report (p. 37), see also the authorities cited in *Benjamin's Sale of Goods* (1974), para. 411, note 48; most of the authorities, like *Mash and Murrell Ltd. v. Joseph I. Emmanuel Ltd.*, [1961] 1 W.L.R. 862, rev'd on other grounds [1962] 1 W.L.R. 16 (C.A.), appear to be concerned with the question as to which of the parties bears the risk of deterioration in transit.

the revised Sale of Goods Act to clarify the status of durability, as it is in an act dealing with consumer warranties. The Saskatchewan Consumer Products Warranties Act, 1977⁹² imports a statutory warranty of reasonable durability, as did Ontario Bill 110.⁹³ It would be anomalous, in our view, if a retailer's basic warranty rights against a manufacturer, who supplies him with a defective product, were to be treated less favourably than the consumer's rights against the retailer when the product is resold to the consumer. We would, however, modify our earlier recommendation in one respect: we would treat reasonable durability as one of the requirements of the warranty of merchantable quality, and not as a wholly separate warranty. This meets the comments of friendly British critics,⁹⁴ who have argued that a separate warranty is not required because the concept of merchantable quality is sufficiently flexible to embrace a requirement of reasonable durability. Accordingly, the Commission recommends that the definition of merchantable quality in the revised Act should require that the goods will remain fit or perform satisfactorily, as the case may be, for a reasonable length of time having regard to all the circumstances.⁹⁵ Finally, we would stress that, as with any other implied warranty, it will be open to sellers under the revised Act to modify the warranty of merchantable quality and to specify their own periods of minimum durability.⁹⁶ To the extent that such provisions are not regarded as unconscionable, sellers should thus be able to avoid the uncertainty to which they object in an undefined statutory term.

(5) Spare Parts and Repair Facilities

*Our Report on Consumer Warranties and Guarantees in the Sale of Goods*⁹⁷ also recommended adding a new implied warranty by the seller that spare parts and reasonable servicing facilities, where relevant, will be available with respect to new goods being sold. After careful consideration, the majority⁹⁸ of the Commission has reached the conclusion that a similar requirement should be included in the revised Act, and so recommends.⁹⁹ On reflection, however, we consider that, as has been done in Bill 110,¹⁰⁰ it might be better to describe this new warranty as a warranty of spare parts and repair facilities, rather than as a warranty of spare parts and servicing facilities.

The reasons for our recommendation are twofold. In the first place, if our *Warranties Report* is implemented and a retail seller is to be held

⁹²S.S. 1976-77, c. 15, s. 11.7.

⁹³Bill 110, 3rd Sess., 30th Legislature (Ont.). As indicated, this Bill received first reading on June 15, 1976, but was not proceeded with.

⁹⁴English Law Commission, Working Paper No. 71, *Law of Contract: Implied Terms in Contracts for the Supply of Goods* (1977), paras. 71-75.

⁹⁵See, Draft Bill, s. 5.13(1)(b)(vi).

⁹⁶See, Draft Bill, s. 5.16.

⁹⁷Supra, footnote 1, pp. 40-41.

⁹⁸Two of the Commissioners, the Honourable J. C. McRuer, and Mr. W. Gibson Gray, dissent in part from this recommendation, and would require only that "spare and replacement parts" rather than "spare parts and repair facilities", be available.

⁹⁹See, Draft Bill, s. 5.13(1)(c).

¹⁰⁰See, s. 5.

responsible to the consumer for the observance of this implied promise, it seems only reasonable that he should be entitled to expect a similar undertaking from the manufacturer. Secondly, given the fact that complex durable products require spare parts and repairs during their lifetime, the availability of spare parts and repair facilities does seem to us to come within the expanded concept of a modern warranty of merchantability. As in the case of durability, the seller will be free to modify, or even to disclaim entirely, this aspect of merchantability, subject, once again, to the test of unconscionability; but, ordinarily, the burden should be on him to do so rather than for the buyer to have to bargain specifically with respect to these features of the goods. The merchant seller is the expert, and he knows the position best. Moreover, as with all other aspects of merchantability, the implication is only a relative one, and it may be rebutted by the surrounding circumstances.¹⁰¹ For example, it may not be reasonable to imply a guarantee of spare parts and repair facilities where a large utility orders to specification a new piece of engineering equipment. Again, the buyer of an exotic imported sports car should appreciate that he may encounter difficulties in having it serviced or repaired in Ontario.

(6) Other Specifications of Merchantability

UCC 2-314(2) provides:

- (2) Goods to be merchantable must be at least such as
 - (a) pass without objection in the trade under the contract description; and
 - (b) in the case of fungible goods, are of fair average quality within the description; and
 - (c) are fit for the ordinary purposes for which such goods are used; and
 - (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
 - (e) are adequately contained, packaged, and labeled as the agreement may require; and
 - (f) conform to the promises or affirmations of fact made on the container or label if any.

It will be recalled that our recommended definition of "merchantable quality" incorporates the provisions of subsection (c), and that subsection (f) has also been dealt with earlier. In our view, the provisions of subsections (a), (b), (d), and (e) could also usefully be incorporated in the revised Ontario Act, and we so recommend.¹⁰² Subsection (a) appears to be covered by existing authority,¹⁰³ and would presumably also be caught by the general requirement that the contract must be construed in accordance with the usage prevailing in a particular trade. Subsection

¹⁰¹Compare, Draft Bill, s. 5.13(1)(c), "unless the circumstances indicate otherwise".

¹⁰²See, Draft Bill, s. 5.13(1)(b).

¹⁰³Jones v. Just (1868), L.R. 3 Q.B. 197.

(b) may be new,¹⁰⁴ but appears to reflect a common contractual requirement for at least some types of fungible commodities.¹⁰⁵ Subsections (d) and (e) are also covered, at least in part, by existing law.

One point remains to be considered under this heading. In *Sumner Permain & Co. v. Webb & Co.*,¹⁰⁶ the English Court of Appeal held that, where goods were bought in England for shipment and resale in the Argentine, the goods were of merchantable quality even though they contained an ingredient not permitted under Argentine law. We have considered whether the revised Ontario provision on merchantability should address itself specifically to this type of problem. We have, however, concluded that this would be neither desirable nor necessary. It would not be right, as a general proposition, to oblige a seller to familiarize himself with the requirements of every jurisdiction to which his goods may be exported. If the foreign buyer seeks compliance with his own law, he should bring this home to the seller. In our view, the implied warranty of fitness is sufficiently flexible to cope with this problem.

(v) *Effect of Buyer's Examination*

Section 15.2 of the Ontario Sale of Goods Act provides that, if the buyer has examined the goods, the condition of merchantable quality does not apply as regards defects that "such examination ought to have revealed".¹⁰⁷ This test has been criticized as being too favourable to the buyer.¹⁰⁸ First, it is said, it encourages the buyer not to examine the goods. Secondly, even if he does examine the goods, the buyer is only deemed to have notice of defects that "such" (that is, his actual) examination ought to have revealed. On a literal reading of this proviso, the buyer is under no obligation to conduct a reasonably careful examination. It will be observed, however, that the test is not wholly subjective, since the buyer will be deemed to be aware of defects which his examination "ought to have revealed". A further criticism is that section 15.2 is not consistent with the buyer's position in the case of a sale by sample, dealt with in section 16(2)(c) of the existing Act, since, in this instance, the seller's warranty only extends to freedom from defects that would not be apparent on "reasonable examination of the sample". The test here is wholly objective.

As to the latter criticism, it is our view that the inconsistency between sections 15.2 and 16(2)(c) is more apparent than real, since the purpose of a sample is to enable the buyer to determine for himself the quality of the goods offered.¹⁰⁹ The first criticism was examined by the

¹⁰⁴For the pre-Code position, see *Williston on Sales* (Rev. ed., 1948), Vol. 1, sec. 243, pp. 641-42; and compare, *Taylor v. Combined Buyers Ltd.*, [1924] N.Z.L.R. 627 (S.C.), 645.

¹⁰⁵Compare, *Christopher Hill Ltd. v. Ashington Piggeries Ltd.*, [1972] A.C. 441 (H.L.).

¹⁰⁶[1922] 1 K.B. 55 (C.A.). Compare, *Winsor & Associates Ltd. v. Belgo Canadian Mfg. Co. Ltd.*, [1975] W.W.D. 173 (B.C.S.C.), following *Niblett Ltd. v. Confectioners' Materials Co. Ltd.*, [1921] 3 K.B. 387 (C.A.).

¹⁰⁷Italics added.

¹⁰⁸See, Law Reform Commission, New South Wales, *Working Paper on The Sale of Goods* (1975), paras. 8.59 *et seq.*

¹⁰⁹*Mody v. Gregson* (1868), L.R. 4 Ex. 49.

English and Scottish Law Commissions.¹¹⁰ The Commissions concluded that it would not be desirable to return to the pre-1893 position, which deemed the buyer to have notice of any defects discoverable on examination whether or not he had examined the goods. We agree with this conclusion. We are somewhat more troubled by the criticism that the buyer who conducts a perfunctory examination of the goods may be better off than the diligent buyer, especially since the Code has avoided this anomaly.¹¹¹ On balance, however, we have decided to recommend no change. The problem does not appear to be of great practical importance, and we believe there is sufficient elasticity in the language of the proviso, coupled with the general requirement of good faith, to enable a court to avoid its unfair operation against either party. Accordingly, our Draft Bill provides that the implied warranty of merchantability does not apply, if the buyer examined the goods before the contract was made, "with respect to any defect that such an examination ought to have revealed".¹¹²

The Law Commissions did not, however, consider the present statutory provision to be entirely satisfactory. The Commissions recommended¹¹³ extending the proviso in one direction by excluding the condition of merchantability with respect to defects in the goods specifically drawn by the seller to the buyer's attention. We support this change and recommend that a similar provision be incorporated in the revised Act.¹¹⁴

(vi) Conclusion: Draft Provision

In the light of the foregoing discussion, we now reproduce our recommended version of the new warranty of merchantable quality.¹¹⁵

(1) In this section 'merchantable quality' means,

(a) that the goods, whether new or used, are as fit for the one or more purposes for which goods of that kind are commonly bought and are of such quality and in such condition as it is reasonable to expect having regard to any description applied to them, the price, and all other relevant circumstances;

and, without limiting the generality of clause *a*,

(b) that the goods

- (i) are such as pass without objection in the trade under the contract description,
- (ii) in the case of fungible goods, are of fair average quality within the description,
- (iii) within the variations permitted by the agreement, are of even kind, quality and quantity within each unit and among all units involved,

¹¹⁰Supra, footnote 22, para. 48.

¹¹¹UCC 2-316(3)(b).

¹¹²See, Draft Bill, s. 5.13(3)(b).

¹¹³Supra, footnote 22, para. 49.

¹¹⁴See, Draft Bill, s. 5.13(3)(a).

¹¹⁵See, Draft Bill, s. 5.13.

- (iv) are adequately contained, packaged and labeled as the nature of the goods or the agreement require,
 - (v) conform to the representations or promises made on the container or label or other material, if any, accompanying the goods, and
 - (vi) will remain fit or perform satisfactorily, as the case may be, for a reasonable length of time having regard to all the circumstances; and
- (c) in the case of new goods, unless the circumstances indicate otherwise, that spare parts and repair facilities, if relevant, will be available for a reasonable period of time.
- (2) Where the seller is a person who deals in goods of the kind supplied under the contract, there is an implied warranty that the goods are of merchantable quality.
- (3) The implied warranty of merchantable quality does not apply,
- (a) as regards defects specifically drawn to the buyer's attention before the contract was made;
 - (b) if the buyer examined the goods before the contract was made, with respect to any defect that such an examination ought to have revealed; or,
 - (c) in the case of a sale by sample or model, with respect to any defect that would have been apparent on reasonable examination of the sample or model.

(c) THE IMPLIED CONDITION OF FITNESS

Where goods are supplied under a contract of sale, a condition of fitness may be implied under section 15.1 of the Ontario Sale of Goods Act. For convenience, we again set out section 15.1:

Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description that it is in the course of the seller's business to supply (whether he is the manufacturer or not), there is an implied condition that the goods will be reasonably fit for such purpose, but in the case of a contract for the sale of a specified article under its patent or other trade name there is no implied condition as to its fitness for any particular purpose.

This section corresponds to former section 14(1) of the U.K. *Sale of Goods Act*. Following the recommendation of the English and Scottish Law Commissions,¹¹⁶ section 14(1) was amended and now appears as section 14(3) of the U.K. *Sale of Goods Act*. This section reads as follows:

14.(3) Where the seller sells goods in the course of a business and

¹¹⁶*Supra*, footnote 22, paras. 30-39.

the buyer, expressly or by implication, makes known to the seller any particular purpose for which the goods are being bought, there is an implied condition that the goods supplied under the contract are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the seller's skill or judgment.

The amended section incorporates the following changes:

- (1) The condition of fitness is no longer confined to sales where the goods are "of a description that it is in the course of the seller's business to supply". It is sufficient that the goods are sold in the course of a seller's business.
- (2) The proviso involving the sale of goods under a patent or trade name has been deleted.
- (3) It is no longer necessary for the buyer to show that he relied on the seller's skill and judgment. Instead, the condition of fitness will be implied unless the circumstances are such as to show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgment.
- (4) The revised section brings the statutory language into alignment with the case law,¹¹⁷ and makes it clear that the "particular purpose" covers a normal or usual purpose as well as a special or unusual purpose.

We support these changes and, with the exception mentioned hereafter, recommend their inclusion in the revised Act.¹¹⁸ The exception to which we refer relates to the opening line of section 14(3) of the U.K. Act, which makes the implied warranty of fitness applicable to all sales by a seller "in the course of a business". Here, consistently with the position adopted by us with respect to the condition of merchantable quality,¹¹⁹ we recommend that the new warranty of fitness continue to be restricted to sales by a seller who deals in goods of the kind supplied under the contract of sale. We realize that, where the seller does not deal in goods of the kind supplied under the contract, there will be no warranty of fitness. This should not, however, preclude a buyer from being able to show that, even though the seller was not a merchant with respect to the goods sold to the buyer, there was communicated reliance on his skill and judgment, and that the seller had expressly warranted the fitness of the goods for the indicated purpose. In such circumstances, we think it better that the burden should rest on the buyer to make out such a case; the seller should not have to show, as apparently he would have to show under the U.K. amendment, that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgment.

The U.K. version of the condition of fitness concludes with the words,

¹¹⁷For example, *Grant v. Australian Knitting Mills Ltd.*, [1936] A.C. 85 (P.C.).

¹¹⁸See, Draft Bill, s. 5.14.

¹¹⁹*Supra*, p. 209; compare, Draft Bill, s. 5.13(2).

"or that it is unreasonable for him to rely". Some concern has been expressed that these words may enable a seller to escape liability where the goods suffer from a latent defect of which he could not reasonably have been aware. The Law Commissions clearly did not intend such a result; nor do we. Like merchantable quality, the condition of fitness is a species of strict liability:¹²⁰ while reliance, express or implied, on the seller's skill or knowledge is a prerequisite to the successful invocation of the condition, questions of negligence have never been relevant in determining the seller's liability.¹²¹ We have considered whether this ambiguous phrase should be deleted in the revised Act, but this would lead to new difficulties. In our Draft Bill,¹²² therefore, we have incorporated the proviso unchanged.

4. SALE BY SAMPLE

Section 16 of the Ontario Sale of Goods Act reads as follows:

16.(1) A contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect.

(2) In the case of a contract for sale by sample, there is an implied condition,

- (a) that the bulk will correspond with the sample in quality;
- (b) that the buyer will have a reasonable opportunity of comparing the bulk with the sample; and
- (c) that the goods will be free from any defect rendering them unmerchantable that would not be apparent on reasonable examination of the sample.

Various commentators¹²³ have pointed out that this section suffers from a number of weaknesses and peculiarities. First, as to section 16(1), it has been objected that the requirement that there cannot be a sale by sample unless there is an express or implied term to this effect, is too rigid; this requirement obliges the court to find a contractual intention that the transaction be a sale by sample. This objection, that a contractual intention must be shown, appears to be the same as the one directed generally to the definition of express warranty; we have dealt with this previously¹²⁴ by deleting the requirement of a contractual intention from that definition.¹²⁵ It follows, if our earlier recommendation is adopted, that whether or not a sale is a sale by sample will depend on the general application of the reliance test for express warranties:¹²⁶ section 5.10(1) of our Draft Bill, in defining "express warranty", refers to a "representation or promise in any form relating to goods". In our view, this wording

¹²⁰Randall v. Newson (1877), 2 Q.B.D. 102 (C.A.).

¹²¹Compare, Frost v. The Aylesbury Dairy Co. Ltd., [1905] 1 K.B. 608 (C.A.).

¹²²See, Draft Bill, s. 5.14(2).

¹²³See, for example, Benjamin's *Sale of Goods* (1974), paras. 835 *et seq*; Law Reform Commission, New South Wales, *Working Paper on The Sale of Goods* (1975), paras. 11.7 *et seq*.

¹²⁴Supra, ch. 6.

¹²⁵See, Draft Bill, s. 5.10(1).

¹²⁶See, *Williston on Sales* (Rev. ed., 1948), sec. 252, pp. 670-71.

is broad enough to encompass any form of communication, whether expressed in words or otherwise, and is meant to include representations conveyed by means of a model or sample.

The other objections relate to section 16(2). It has been contended that, by force of section 16(2)(c), the condition of merchantability applies to goods whether or not the seller is a merchant with respect to those goods; on the other hand, the general implied condition of merchantability, as contained in section 15.2, applies only where the seller is a person who deals in goods of that description. This is an oversight that should be corrected in the revised Act, and we so recommend. Another difficulty is that, as to examination, the section imposes a higher degree of care on a buyer where the sale is by sample than does section 15.2, where the sale is not by sample. We have dealt with this previously¹²⁷ and have expressed the view that the inconsistency is more apparent than real. Finally, section 16(2)(b) appears to be redundant, since section 33 of the Act confers on the buyer a general right to examine goods for conformity at the time of delivery if he has not examined them previously.

Apart from these observations, our general conclusion is that there is no longer need for a separate section 16, and that those parts that retain their utility can be readily absorbed in other provisions of the revised Act.¹²⁸

5. IMPLIED WARRANTIES IN A LEASE OF GOODS¹²⁹

The implied warranties and conditions in *The Sale of Goods Act* do not apply to leasing contracts; nor is there any other Ontario statute that clarifies the position with respect to the applicability to leasing contracts of the implied warranties and conditions in a contract of sale. In a previous chapter,¹³⁰ we indicated our support for clarification. We turn now to consider what types of provision might be appropriate. Once again, we emphasize that the following observations are only directed to true leases of goods; leases that are in substance disguised secured sales will, following our earlier recommendation,¹³¹ be governed by the revised Act so far as their sales incidents are concerned.

It may be useful to begin with a summary of the current common

¹²⁷Supra, this chapter, sec. 3(b)(v).

¹²⁸Section 16(1) has been deleted and subsumed under the definition of express warranty in section 5.10(1) of the Draft Bill. Section 16(2)(a) of the existing Act has been incorporated in section 5.11(1)(b) of the Draft Bill dealing with the express warranty of description. Section 16(2)(b) has been absorbed in section 7.12(1) of the Draft Bill. Section 16(2)(c) of the existing Act appears in altered form in section 5.13(3)(c) of the Draft Bill.

¹²⁹We use the terms lease, rental and hire interchangeably. In North America "lease" tends to be used for longer term bailments for use and "rental" for short term purposes. "Hire" appears to be the favoured British term for both types of arrangement, although the terminology fluctuates on both sides of the Atlantic.

¹³⁰Supra, chapter 4, sec. 3(f).

¹³¹Ibid.

law position.¹³² It would appear¹³³ that substantially the same implied terms of description and correspondence to sample apply to a lease transaction as in a sale; but there is no authority with respect to the status of the implied term of merchantability. The decisions do not mention "merchantability" as such, only "fitness".¹³⁴ The scope of the implied term of fitness in a leasing transaction also requires clarification.¹³⁵ First, it is not clear whether the implied term amounts to a condition or warranty. Secondly, and more importantly, it is unsettled in Anglo-Canadian law whether the lessor warrants the fitness of the chattel absolutely, or whether his obligation is limited to providing a chattel as fit as reasonable care and skill can make it.¹³⁶

There are also difficulties with respect to the implied terms of title and absence of encumbrances. It is settled law¹³⁷ that the lessor does not warrant his title, only quiet possession. This is unlike a hire-purchase agreement where, since *Karflex Ltd. v. Poole*,¹³⁸ the courts have been willing to imply a condition of title in the hirer's favour. It is uncertain whether the lessor in a true lease warrants that the goods are free from encumbrances,¹³⁹ although, logically, the position should be the same as with respect to the implied term of title. It may be thought that the warranty of quiet possession is sufficient to protect the lessee in all foreseeable circumstances; but it has been argued¹⁴⁰ that this assumption may not be correct. The case is posited of a lessee who is sued in conversion by the true owner after the lease has terminated and the goods have been returned to the lessor. In such circumstances, it is argued, the implied warranty of quiet possession would not have been breached, and it might be difficult for the lessee to seek indemnity from the lessor in the absence of an implied term of title. However, even if this argument is correct and there is a gap in the existing legal framework, it does not follow that the implication of a warranty of title in all leases, regardless of their duration or other features, is the proper solution. The cure could be worse than the disease. We return to this problem below.

The common law position has recently been reviewed by the English Law Commission.¹⁴¹ The Commission concluded that,¹⁴² except with respect to the implied term of title, there is a close similarity between the

¹³²See, generally, Law Commission Working Paper No. 71, *Law of Contract: Implied Terms in Contracts for the Supply of Goods* (1977), Part III.

¹³³*Ibid.*, para. 47.

¹³⁴*Ibid.*, para. 61.

¹³⁵*Ibid.*, paras. 49 *et seq.*

¹³⁶Compare, Law Commission W.P. No. 71, footnote 132 *supra*, paras. 48-59. In Canada, *Boorman v. Morris*, [1944] 2 W.W.R. 12 (Alta. S.C.), *Matheson v. Watt* (1956), 19 W.W.R. 424 (B.C.C.A.), and *Crawford v. Ferris*, [1953] O.W.N. 713 (H.C.J.), all show a preference for the qualified liability theory. See, also, *Canadian-Dominion Leasing Corp. Ltd. v. Suburban Superdrug Ltd.* (1966), 56 D.L.R. (2d) 43 (Alta. S.C., App. Div.), where the stricter standard appears to have been applied, but without discussion.

¹³⁷Law Com. W.P. No. 71, footnote 132 *supra*, para. 46.

¹³⁸[1933] 2 K.B. 251.

¹³⁹Law Com. W.P. No. 71, footnote 132 *supra*, para. 46.

¹⁴⁰Goode, *Introduction to The Consumer Credit Act, 1974*, para. [9.20].

¹⁴¹*Supra*, footnote 132.

¹⁴²*Ibid.*, para. 64, p. 39.

terms implied in a contract of sale and a contract of hire, and that the terms implied in these two types of contract should now be assimilated "yet more closely". The Commission gave several reasons for its recommendations, one of which was¹⁴³ "the desirability of producing overall consistency in the law relating to contracts for the supply of goods". More specifically, the substance of the Commission's recommendations was as follows:¹⁴⁴

- (1) With the exception of the implied undertakings as to title, the implied obligations of the supplier in respect of goods supplied under a contract of hire should be assimilated to those implied in a contract of sale; and
- (2) that the following terms should be implied with respect to the supplier's title and the hirer's right to quiet possession; namely, that
 - (a) the supplier has the right to hire out the goods throughout the period of hire;
 - (b) the goods are free and will remain free, throughout the period of hire, from any charge or encumbrance not disclosed to the hirer before the agreement was made; and
 - (c) the hirer is entitled to quiet possession of the goods throughout the period of hire.

We agree with the first recommendation and with items (a) and (c) in the second recommendation; indeed, the introduction of an implied term that the lessor has the right to lease out the goods, such as is contained in item (a), should resolve the case posited above. Accordingly, we recommend that these provisions be incorporated in the revised Act. We are, however, unable to support item (2)(b). If it is assumed, as the Law Commission assumed, that the lessee in a true lease does not require the protection of a warranty of title,¹⁴⁵ then it is difficult to justify the introduction of a warranty of freedom from encumbrances. The Law Commission provides no clear reason for this recommendation, other than the fact that the U.K. *Supply of Goods (Implied Terms) Act 1973*¹⁴⁶ contains such an implied term with respect to hire-purchase agreements. In our view, this analogy is not apt. A hire-purchase agreement is only a disguised form of conditional sale, a fact that the U.K. Act recognizes by also importing a condition of title in the hirer's favour in the case of a hire-purchase agreement. Moreover, there are functional considerations that militate against the introduction of an implied term of freedom from encumbrances. It is not unusual for a professional lessor to give a security interest in all or part of his inventory. Serious difficulties might arise if a lessee were held entitled to repudiate a leasing agreement because he had not previously been told that the chattels leased to him were subject to a

¹⁴³Ibid., para. 64, p. 40.

¹⁴⁴Ibid., para. 79, p. 50.

¹⁴⁵Ibid., para. 65.

¹⁴⁶1973, c. 13 (U.K.), s. 8(1)(a).

security interest, even though there was no interference with his quiet possession.¹⁴⁷

Subject to the exception we have noted, and a further point of difference about to be mentioned, we support, and our Draft Bill¹⁴⁸ seeks to give effect to, the Law Commission's recommendations. Since our Draft Bill abolishes the distinction between warranties and conditions, it follows that the same will be true with respect to the implied terms in a leasing contract. This may raise a question with respect to the remedies of an aggrieved lessee. Our Draft Bill does not purport to assimilate the remedies of a lessee with those of a buyer, but we anticipate no difficulty in the courts' applying by analogy the remedial provisions in the Draft Bill. In particular, we anticipate that the courts will have no difficulty in applying the concept of substantial breach as governing the lessee's right to reject defective goods.

6. CUMULATION AND CONFLICT OF EXPRESS AND IMPLIED WARRANTIES

Section 15.4 of the Ontario Sale of Goods Act provides:

An express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith.

The English and Scottish Law Commissions observed¹⁴⁹ that the logical place for this provision was section 55 of the U.K. Act, which corresponds to section 57 of the Ontario Act. The Commissions did not, however, address themselves to a more important difficulty; namely, that section 15.4 does not provide constructional guidance where the express and implied terms appear to be in conflict. A virtue of UCC 2-317 is that it attempts to provide such guidance. This section reads as follows:

2-317. Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

- (a) Exact or technical specifications displace an inconsistent sample or model or general language of description.
- (b) A sample from an existing bulk displaces inconsistent general language of description.

¹⁴⁷It might be argued that the holder of a long term lease is more analogous to a buyer than a "mere" hirer and that his rights, at least, should be assimilated to those of a buyer. There is some support for this suggestion in the proposals of the Saskatchewan Law Reform Commission to treat chattel leases for more than a year as creating a security interest. See Law Reform Commission of Saskatchewan, *Proposals for a Saskatchewan Personal Property Security Act* (July, 1977), s. 2(34)(iv). Without necessarily rejecting the suggestion, for the purpose of a revised Sale of Goods Act we think the lessee would be sufficiently protected by allowing him to invoke, by analogy, the right to seek an adequate assurance of performance from the lessor: see, Draft Bill, s. 8.9.

¹⁴⁸See, Draft Bill, s. 5.15.

¹⁴⁹Supra, footnote 22, para. 56.

- (c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

It is not clear to what extent these provisions change prior law.¹⁵⁰ In any event, UCC 2-317 is, in our view, superior to section 15.4, and we recommend the adoption of a similar provision in the revised Act.¹⁵¹

The rationale of UCC 2-317(c) may not be obvious at first sight, and the following illustration offered by a learned commentator may be helpful:¹⁵²

Suppose that a written contract for the purchase of refrigeration equipment for a cold storage room includes express warranties that the motor is of 3 H.P. and the equipment will deliver 10 tons of refrigeration. These specifications reflected seller's judgment of the size required to cool buyer's room. The unit is too small, and buyer seeks to recover for breach of an implied warranty of fitness based on seller's knowledge of the size of the cold storage room and buyer's reliance on seller's skill and judgment to select a unit of sufficient capacity.

On these facts, seller might contend that the specifications as to capacity written into the contract are inconsistent with an implied warranty of fitness based on buyer's contention that the unit should be larger. Section 2-317(c) of the Code meets this argument; the implied warranty of fitness would prevail.

Anglo-Canadian case law appears to support this result.¹⁵³

7. REGULATION OF DISCLAIMER CLAUSES¹⁵⁴

(a) A GENERAL APPROACH

The doctrine of unconscionability finds its most fruitful application in policing a common practice by manufacturers and merchants: namely, the exclusion or restriction of the conditions and warranties implied in the buyer's favour under *The Sale of Goods Act*, and the remedies that the law confers upon a buyer for breach of the seller's warranty obligations.¹⁵⁵ The replies to the C.M.A. Questionnaire, and the contract forms made available to the Research Team, indicate that such attempts are

¹⁵⁰On this point, see, NYLRC Study, ch. 5, footnote 52, *supra*, pp. (410)-(413); and Duesenberg and King, *Sales and Bulk Transfers Under the Uniform Commercial Code*, Bender's Uniform Commercial Code Service, Vol. 3, pp. 7.52.22-7.53.

¹⁵¹See, Draft Bill, s. 5.17.

¹⁵²See, NYLRC Study, footnote 150 *supra*, p. (412).

¹⁵³*Baldry v. Marshall*, [1925] 1 K.B. 260 (C.A.); *Nicholson and Venn v. Smith-Marriott* (1947), 177 L.T. 189 (K.B. Div.); and, *Wallis, Son & Wells v. Pratt & Haynes*, [1911] A.C. 394 (H.L.). See, also, *North-West Thresher Co. v. Andrews* (1908), 8 W.L.R. 827 (Alta. S.C., Tr. Div.).

¹⁵⁴See, also, Michael Trebilock, "Disclaimer Clauses", Research Paper No. III.5.

¹⁵⁵While the question of remedies is dealt with in later chapters, it will be convenient to deal at this point with the question of disclaimer clauses as they relate to remedies for breach of the warranties.

almost as frequent in commercial sales as they are with respect to consumer goods.

The legitimacy of disclaimer clauses in consumer transactions was examined extensively by this Commission in its *Report on Consumer Warranties and Guarantees in the Sale of Goods*. We concluded that,¹⁵⁶ on balance, such clauses could not be justified. Our Report, therefore, recommended that the use of disclaimer clauses should be prohibited in consumer sales, and that exceptions to the general rule should only be permitted in carefully regulated circumstances.¹⁵⁷ To what extent should this recommendation be extended to commercial sales?

We are firmly of the view that the solution adopted in our *Warranties Report* would be too draconian in the context of commercial sales. We believe that there are sufficient differences between consumer sales and commercial sales, each taken as a group, to justify a different approach in the case of commercial sales. The rationale for disallowing disclaimer clauses in consumer transactions is the serious disparity in bargaining power, resources, and knowledge between the average consumer, on the one hand, and the retailer from whom he makes his purchase or the manufacturer who produces the goods, on the other. It seems right, therefore, that the burden of absorbing the loss resulting from the distribution of defective goods should fall, ultimately, on the manufacturer who, in most cases, is best able to absorb such losses. These assumptions do not hold true in the case of non-consumer sales; or, at any rate, do not hold true with sufficient regularity to justify the application of identical disclaimer rules. One would not seriously contend, for example, that a government department is incapable of protecting its own interests when purchasing supplies, or that a large automobile manufacturer does not bargain from a position of equal strength when dealing with its own suppliers.

This is not to say that, in the commercial context, buyer and seller are always bargaining on equal terms, and that the buyer is always capable of protecting his own interests.¹⁵⁸ The proposition is manifestly untenable. The dividing line between a consumer sale and a commercial sale is often a fine one, and many non-consumer buyers are not noticeably more sophisticated, or in a better bargaining position, than the average consumer. We are, therefore, agreed that what is required is a flexible approach that will enable the court to take into account fully the circumstances of individual cases. In our view, the doctrine of unconscionability is as apt to fill this office with respect to disclaimer clauses, as it is in relation to other terms that are impugned on the grounds of their gross unfairness.

We have earlier recommended¹⁵⁹ that the revised Act should incorporate a general unconscionability provision. We feel that this provision

¹⁵⁶See, Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), p. 49.

¹⁵⁷Compare, Bill 110, 3rd Session, 30th Legislature (Ont.), s. 8(1).

¹⁵⁸This point is forcibly argued in Professor Trebilcock's research paper, footnote 154 *supra*, pp. 38 *et seq.*

¹⁵⁹*Supra*, ch. 7.

will confer upon the courts an explicit policing power that will serve the business community better than the approach currently adopted by the courts. As we noted in our *Warranties Report*,¹⁶⁰ and as has been documented again in the research paper prepared for the Commission on this topic,¹⁶¹ the courts, under the guise of rules of construction or doctrines of fundamental breach, now regularly disregard even the clearest disclaimer clauses. Unfortunately, this is not being done on any rational basis. Sometimes, indeed, the process occurs in the face of compelling evidence that the buyer had freely accepted the disclaimer clause, and was just as capable of absorbing the loss that occurred as was the seller.¹⁶² There is no guarantee that the introduction of the doctrine of unconscionability will lead to a swift reversal in the present judicial approach to disclaimer clauses. In the long run, however, it should result in a more balanced attitude, and in a more explicit canvassing of the competing interests that strive for recognition.¹⁶³

Accordingly, the Commission recommends the insertion of a provision in the revised Act to the following effect:¹⁶⁴

Subject to the provisions of this Act on unconscionability,¹⁶⁵

- (a) a warranty implied under this Act;
- (b) the effect of a representation or promise which would otherwise amount to an express warranty; and

¹⁶⁰Supra, footnote 156, ch. 3, especially at pp. 50 *et seq.*

¹⁶¹Supra, footnote 154, pp. 10 *et seq.*

¹⁶²See, for example, *Canso Chemicals Ltd. v. Canadian Westinghouse Co. Ltd.* (1974), 54 D.L.R. (3d) 517 (N.S.C.A.); *R. G. McLean Ltd. v. Canadian Vickers Ltd. et al.*, [1971] 1 O.R. 207, 15 D.L.R. (3d) 15 (C.A.); *Harbutt's Plasticine v. Wayne Tank and Pump Co. Ltd.*, [1970] 1 Q.B. 447, [1970] 1 All E.R. 225 (C.A.).

¹⁶³This hope is borne out by the recent decision of Griffiths, J., in *R. W. Green Ltd. v. Cade Bros.*, [1978] 1 Lloyd's Rep. 602(Q.B.).

¹⁶⁴See, Draft Bill, s. 5.16(1).

¹⁶⁵One of the Commissioners, the Honourable Richard A. Bell, believes that an obligation of good faith should be a prerequisite to the effectiveness of a disclaimer clause and that this should be reflected in section 5.16(1) of the Draft Bill. At one stage, the Commission had agreed that the running head in section 5.16(1) should read "Subject to the provisions of this Act on unconscionability and *good faith*". The italicized words were omitted in the final draft (with Mr. Bell dissenting) on the ground that, under the structure of the Draft Bill, the obligation of "good faith" relates to performance and not to formation of the contract of sale. While Mr. Bell has grave reservations about the structure of the Draft Bill not requiring "good faith" in the formation as well as the performance of the contract, he believes that the control of disclaimer clauses is so vital that, whatever the structure of the Draft Bill, "good faith" should be an imperative element in testing the attempt to disclaim statutory rights and obligations. The objection to the original draft of the running head on the ground of the structure of the Draft Bill could be met by revising it to read, "Subject to the provisions of this Act on unconscionability and provided the parties act in *good faith*".

Mr. Bell expresses vigorously his opinion that the criteria in section 5.2 of the Draft Bill are not sufficiently broad to protect a purchaser from a vendor acting in bad faith. Bad faith in itself does not render a contract unconscionable, but in Mr. Bell's opinion, it should operate to prevent a party from disclaiming what would otherwise be his statutory obligations.

(c) the remedies for breach of a warranty,
may be modified, limited or excluded by agreement of the parties.

The adoption of such a provision will not, however, answer all the questions involving the use of disclaimer clauses. We turn now to consider a number of specific issues, including the broader topic of the extent to which the revised Act should provide guidelines with respect both to permissible types of disclaimer clauses, and to those that *prima facie* will be deemed unreasonable. Article 2 contains a substantial number of indices of both types.

(b) SPECIFIC ISSUES¹⁶⁶

(i) *Construction of Terms that Limit or Negate Express Warranties*

This problem has been touched on in an earlier context, but needs now to be considered a little more fully. It may be stated in this way. In one part of an agreement, a seller may undertake to confer particular benefits on the buyer; for example, to supply seed of a particular description. Another part of the agreement may, however, appear to deny such entitlement; for example, by means of a clause excusing the supplier if the seed supplied is not of the correct description.¹⁶⁷ How can these provisions be reconciled? The present Ontario Sale of Goods Act provides no guidance. As has been noted previously, section 15.4 addresses itself to the interrelationship of express and implied warranties. This provision has no bearing on the construction of a term of the agreement, not amounting to a warranty, that purports to *limit or negate* an express warranty. The courts have generally shown themselves hostile to attempts to negate express warranties. UCC 2-316(1) reflects the same approach, and provides:

2-316.(1) Words or conduct relevant to the creation of an express warranty^[168] and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

This provision, while adding nothing inherently new, is useful: it makes it clear that where, and to the extent that, an express warranty and a term of the contract tending to negate the express warranty cannot be reason-

¹⁶⁶The treatment of disclaimer of title clauses has already been discussed previously, and is therefore omitted in the present discussion. See *supra*, this chapter, sec. 1(f).

¹⁶⁷Compare, *Wallis, Son & Wells v. Pratt & Haynes*, [1911] A.C. 394 (H.L.).

¹⁶⁸This circuitous phrasing was apparently adopted in response to criticism by the NYLRC Study of an earlier version of UCC 2-316(1). This provided that "if an agreement creates an express warranty, words disclaiming it are inoperative". The objection raised was the familiar one that one cannot determine whether or not an express warranty exists until all the terms of the agreement have been examined. The revised language was designed to overcome this objection.

ably construed as consistent with each other, the express warranty prevails. We recommend the adoption of a similar provision in the revised Act. In view of our earlier recommendation, however, this new provision should contain no reference to the parol evidence rule.¹⁶⁹

We recognize a possible objection that such a provision would merely invite the courts to re-introduce the doctrine of fundamental breach, and would enable them to avoid difficult enquiries about the fairness of the impugned disclaimer provision. This is not our intention; nor was it the intention of the Code. We would expect the courts to rely upon the doctrine of unconscionability rather than upon constructional techniques in order to prevent what the courts might feel was an unreasonable result. In any event, this possibility is not, in our view, a sufficient reason for denying statutory recognition to a well established rule of construction.¹⁷⁰

(ii) Guidelines Concerning Exclusion or Modification of Implied Warranties: UCC 2-316

We have already recommended that disclaimer clauses should not be prohibited, but should be controlled by the doctrine of unconscionability. Subsections (2) and (3)(a) of UCC 2-316 contain specific guidelines that spell out the means by which, or the circumstances in which, the implied warranties can be excluded or modified. These subsections provide as follows:

2-316.(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that 'There are no warranties which extend beyond the description on the face hereof.'

(3) Notwithstanding subsection (2)

- (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like 'as is', 'with all faults' or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty;

Subsection (2) deals with the use of appropriate written terms to exclude the implied warranties of merchantability or fitness. Subsection (3)(a) sanctions the use of such exculpatory expressions as "as is", "with all faults", or other language "which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty".

¹⁶⁹See, Draft Bill, s. 5.16(3).

¹⁷⁰See, for example, *Sloan v. Empire Motors Ltd.* (1956), 18 W.W.R. 145, 3 D.L.R. (2d) 53 (B.C.C.A.), where the Court relied on the express language of the agreement in order to deny effect to a conflicting disclaimer clause.

Two principal objections have been expressed with respect to these provisions.¹⁷¹ One is that they lead to successive and partly conflicting layers of review of the admissibility of disclaimer clauses. The other is that to sanction the effectiveness of linguistic formulae is to invite their ritualistic incantation, without regard either to whether they have any meaning to the buyer in a particular case, or to whether the buyer is free to reject the imposition of such terms.

We accept both these criticisms, and we do not recommend adoption of these features of UCC 2-316. The great volume of litigation that they have spawned¹⁷² indicates the difficulty of framing categorical rules to control the type of language that is sufficient to exclude the implied warranties. Even such familiar terms as "as is", and goods sold "with all faults", are susceptible of different meanings. Their uncritical acceptance can lead to mischievous results if not subjected to an overriding test of unconscionability. A basic, and, in our view, irremediable, weakness about UCC 2-316(2) and (3)(a) is that they ignore the many other considerations that should go into determining whether the use of exculpatory terms, in a particular context, is fair. In short, there is a fundamental conflict between the flexibility of the approach adopted in UCC 2-302, in dealing with questions of unconscionability, and the rigidity of the solutions offered in UCC 2-316.

While we do not support the Code's linguistic formulae, we have, by recommending the inclusion in the revised Act of the above-mentioned explicit provision governing disclaimer of warranty obligations,¹⁷³ recognized the value of making it clear that the freedom of the parties to make their own contract also applies to the exclusion of express and implied warranties and the remedies for their breach.

(iii) *Disclaimer Clauses Deemed Prima Facie Unconscionable*

At the other end of the spectrum there is, as mentioned, the question of whether the revised Act should contain guidelines with respect to the types of disclaimer clauses that are *prima facie* unacceptable. UCC 2-719(3) provides, in part, as follows:

. . . Limitation of consequential damages for injury to the person in the case of consumer goods is *prima facie* unconscionable but limitation of damages where the loss is commercial is not.

As American commentators have noted,¹⁷⁴ there is an apparent inconsistency between this provision and UCC 2-316(2). UCC 2-316(2) allows the seller to exclude the implied warranties of merchantability and fitness. It seems anomalous that the roots can be severed, but not the branches.

¹⁷¹See, Trebilcock, footnote 154 *supra*, pp. 46-47.

¹⁷²See, for example, the cases digested in Uniform Laws Annotated, *Uniform Commercial Code*, Vol. IA, sub. UCC 2-316; and the discussion in White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), ch. 12, and in Tracy, "Disclaiming and Limiting Liability for Commercial Damages" (1978), 83 Com. L.J. 8.

¹⁷³See *supra*, this chapter, sec. 7(a), and Draft Bill s. 5.16(1).

¹⁷⁴For example, White & Summers, footnote 172 *supra*, pp. 392 *et seq.*

Presumably, the inconsistency is due to an oversight. It may also be objected that public opinion has moved substantially since Article 2 was drafted, and that contractual attempts to disclaim liability for injury to the person should be outlawed altogether. We recognize the force of this reasoning. Nevertheless, we prefer to follow the Code's more modest precedent, on the ground that specific questions of products liability are better left for disposition to a law on products liability. We would, however, expand the scope of the Code language to embrace injury to the person caused by any type of goods, whether consumer goods or not, particularly since, in Ontario, *The Consumer Protection Act*¹⁷⁵ already regulates the use of disclaimer clauses in consumer sales, and because they were the subject of further recommendations in our *Warranties Report*.¹⁷⁶ We have been puzzled by the meaning of the phrase in UCC 2-719(3), "where the loss is commercial". We have not been able to gain any guidance from the case law¹⁷⁷ and, in its absence, have concluded that the draftsman was referring to "economic losses". We believe, accordingly, that these words should be substituted for the Code language. Subject to these changes, we recommend the adoption of a provision comparable to UCC 2-719(3) in the revised Act.¹⁷⁸

We have also considered the desirability of a general prohibition of exemption clauses purporting to exclude liability for negligent acts.¹⁷⁹ Such clauses are more commonly found in contracts for the supply of services than in contracts of sale, and they have generally encountered much judicial resistance.¹⁸⁰ However, they have not so far been declared to be contrary to public policy. When negligence is involved in the manufacture or distribution of consumer goods, the consumer will normally find it simpler to sue for breach of warranty. This is so, partly because liability for breach of warranty is strict, and partly because *The Consumer Protection Act*¹⁸¹ avoids the effectiveness of disclaimer clauses in consumer sales. It is, therefore, only in the context of non-consumer sales that a disclaimer of liability for negligent acts is likely to be of practical importance.

Section 2(1) of the U.K. *Unfair Contract Terms Act 1977*¹⁸² now outlaws disclaimer clauses purporting to exclude or restrict liability that would otherwise be imposed upon a business person for death or personal injury resulting from negligence. We have already discussed this issue.

¹⁷⁵R.S.O. 1970, c. 82 as am.

¹⁷⁶Supra, footnote 156, pp. 61-62.

¹⁷⁷See, for example, *Billings v. Joseph Harvis Co., Inc.* (1975), 27 N.C. App. 689, 18 U.C.C. Rep. 359, aff'd (1976), 226 S.E. 2d 321 (N.C.S.Ct.); *Morrow v. New Moon Homes, Inc.* (1976), 548 P. 2d 279 (Alaska S. Ct.); *Posttape Associates v. Eastman Kodak Co.* (1976), 19 U.C.C. Rep. 832 (U.S. Ct. App. 3d Cir.); *D.O.V. Graphics, Inc. v. Eastman Kodak Co.* (1976), 347 N.E. 2d 561 (Ohio C.P.).

¹⁷⁸See, Draft Bill, s. 5.16(2).

¹⁷⁹See the discussion of the English and Scottish Law Commissions in Law Com. No. 69, Scot. Law Com. No. 39, *Exemption Clauses, Second Report* (1975), Part III.

¹⁸⁰Ibid., paras. 39-40.

¹⁸¹R.S.O. 1970, c. 82 as am., s. 44a.

¹⁸²1977, c. 50 (U.K.).

Subsection (2) applies a similar rule to other types of loss or damage, unless the exculpatory clause satisfies the requirement of reasonableness.¹⁸³ We have considered recommending the adoption in the revised Act of a provision similar to section 2(2) of the U.K. Act, but have been persuaded against it by a number of considerations.

First, the departure from reasonable standards of care may be technical, and may not reflect moral blameworthiness. When this is coupled with the fact that the seller's liability for negligent conduct may be vicarious, one should not assume that the imposition of liability is required by some mandatory policy to punish wrongdoing. Secondly, the seller may have a legitimate interest in limiting the rather open-ended liability for consequential loss that the law would otherwise allow. It is difficult to assess the magnitude of this loss and to spread it adequately by means of the seller's insurance or pricing structure. The difficulty of predicting consequential losses arising from negligent conduct is just as great as that of predicting consequential losses for latent defects. Finally, a disclaimer for negligent conduct may be part of a legitimate scheme between the parties to rationalize their insurance coverage. It may be the easiest way to avoid duplication of coverage and to provide adequate insurance that protects both parties at the cheapest cost.

Our abstentionist conclusion is not intended to bestow any kind of approval on exculpatory clauses involving negligence. These clauses will be controlled by the general provisions on unconscionability and good faith. It means, simply, that there will be no presumption of unconscionability, but that, as with respect to other types of disclaimer clause not involving claims for personal injury, the burden will rest with the aggrieved party to make out his case.

(iv) *Disclaimer Clauses in Non-Privity Cases*

In chapter 6, we discussed the definition of express warranty. We recommended that this definition should not be confined to representations and promises made by an immediate seller, but should embrace representations and promises made to a buyer by any other person involved in the manufacture or distribution of the goods. The question that now arises is the extent to which such persons should be able to avail themselves of disclaimer clauses where they are alleged to have breached a warranty. The question may arise in two situations.

The first situation is where the original representation is itself qualified by a disclaimer clause, either as to its scope or as to the remedies available to the buyer. Since, in an action against the original representor, the ultimate buyer's claim is for breach of warranty, in principle the defendant should be entitled to rely on an exculpatory clause, subject to the usual test of unconscionability, just as he could if the parties were in privity with each other. The second situation arises where the original

¹⁸³A similar requirement of reasonableness applies in the case of attempts to exclude the implied conditions of description, merchantability and fitness in a contract for the sale of non-consumer goods: the *Unfair Contract Terms Act 1977*, c. 50 (U.K.), s. 6(3).

representation, for example, a television commercial, contains no qualifications, but where a disclaimer clause appears in the written guarantee by the original representor accompanying the goods. The answer to the question whether this disclaimer clause will protect the original representor should turn, it seems to us, in part on whether or not it was reasonable for the buyer to take the original representation at face value, and in part on whether the disclaimer clause came to the buyer's attention before he acted in reliance on the representation. If the buyer did learn of the disclaimer clause before he acted in reliance on the representation, then, once again, the representor should be entitled to invoke the disclaimer clause by way of defence. A more complex situation would arise where the buyer did not hear or see a representation made to the public before making his purchase, but where, pursuant to our earlier recommendation,¹⁸⁴ such a representation is held to constitute an express warranty. In these circumstances, in our view, fairness requires that the original representor should not be entitled to rely on the disclaimer clause, unless it came to the buyer's attention or unless the buyer could reasonably have been expected to learn of the disclaimer before buying the goods or relying upon the representation.

Since, for the first time, we are giving statutory recognition, in a general sales act, to the doctrine of collateral warranty, it would be helpful, in our view, to add provisions governing the admissibility of exculpatory clauses in circumstances such as those we have just described. We therefore recommend¹⁸⁵ that the provisions in the revised Act on disclaimer clauses should apply to an express representation or promise made by a manufacturer or other distributor

- (a) where the modification, limitation or exclusion comes to the buyer's attention before he acts in reliance upon the representation or promise; or
- (b) where the representation or promise is made to the public, and the buyer may reasonably be expected to learn of the modification, limitation or exclusion before buying the goods or relying upon the representation or promise.

These recommendations are confined to express representations or promises made directly by a prior seller to an ultimate buyer. They do not encompass the problems that arise when the ultimate buyer seeks to rely on express and implied warranties obtaining between *his* seller and a prior party. It will be convenient to postpone discussion of these issues to chapter 10 of this Report.

(v) Deemed Adoption of Disclaimer Clauses by Retailer

Earlier in this Report,¹⁸⁶ we discussed the question of the extent to which a merchant seller should be deemed to adopt representations relating to the goods that originated not from the merchant seller, but from a

¹⁸⁴See, Draft Bill, s. 5.10(1)(a).

¹⁸⁵See, Draft Bill, s. 5.16(4).

¹⁸⁶Supra, ch. 6, sec. A.2(d).

third party, typically the manufacturer or producer. Our recommendation was that there should be no general presumption of deemed adoption, except in so far as it was necessary to give meaning to the concept of merchantable quality; that is, the merchant seller should be deemed to adopt the promises or representations made on the container or label or other material accompanying the goods.¹⁸⁷ The question that now needs consideration is the extent to which a seller should be entitled to rely on a prior seller's exculpatory clauses, or other forms of limitation accompanying or preceding the goods. The problem is not dealt with either in *The Sale of Goods Act* or in Article 2, and the answer would appear to turn on general principles of contract law, and in particular on doctrines of privity and third party beneficiaries.¹⁸⁸ It would seem to follow that the retailer cannot rely on the prior seller's exculpatory clause, unless he can show that it was also incorporated in the terms of his own contract; or, possibly, that the prior seller acted jointly on behalf of himself and the retailer.¹⁸⁹ It is not usual for retail agreements to refer expressly to another person's disclaimer clauses, or for a manufacturer to seek to protect the retailer as well as himself. What little case law there is on the point¹⁹⁰ suggests that the courts will generally be hostile to implying such clauses in the retail merchant's favour.

A more sympathetic view was taken by the Massachusetts court in *Taylor v. Jacobson*.¹⁹¹ This case involved the sale of a brand name cosmetic by a druggist to a consumer who proved allergic to this cosmetic. The Court observed as follows:¹⁹²

As a practical matter, when a retail druggist sells (without express warranties or representations of his own) one of the many thousand manufactured products in his stock in trade, which has been asked for by trade name, it is a necessary inference that he adopts as his own any cautionary statements, disclaimers and limitations of warranties made (on the package and in accompanying circulars) by the manufacturer who best knows the infirmities of his product.

¹⁸⁷See, Draft Bill, s. 5.13(1)(b)(v).

¹⁸⁸As to which, see, generally, Treitel, *The Law of Contract* (4th ed., 1975), ch. 15; Fridman, *The Law of Contract in Canada* (1976), ch. 14.

¹⁸⁹Compare, *Scrutons Ltd. v. Midland Silicones Ltd.*, [1962] A.C. 446 (H.L.), dist'd in *The New Zealand Shipping Co. Ltd. v. A. M. Satterthwaite & Co. Ltd. ("The Eurymedon")*, [1975] A.C. 154, [1974] 1 All E.R. 1015 (P.C.); Treitel, *supra*, pp. 427-31.

¹⁹⁰Duesenberg and King, footnote 150 *supra*, p. 7.52.18, note 64, citing *Sokoloski v. Splann* (1942), 40 N.E. 2d 874 (Mass. Sup. Jud. Ct.); *Jolly v. C.E. Blackwell & Co.* (1922), 211 P. 748 (Wash. S. Ct.); *Marino v. Maytag Atlantic Co.* (1955), 141 N.Y.S. 2d 432 (Mun. Ct.). We are not aware of any Anglo-Canadian case in which the question has arisen in a similar context. The leading cases, cited in footnote 189 *supra*, involved exculpatory clauses in contracts for the carriage of goods. The other important difference between those cases and the problem considered in the text is that there is a clear contractual nexus between the buyer and the retail seller, whereas the nexus was not admitted by the plaintiffs who were suing the stevedores in the carrier cases.

¹⁹¹(1958), 147 N.E. 2d 770 (Mass. Sup. Jud. Ct.), cited in Duesenberg and King, footnote 150 *supra*, p. 7.52.18.

¹⁹²*Ibid.*, at p. 774.

It is obvious that the Court was moved by sympathy for the druggist's position. Where, on the facts, it is reasonable to infer that the seller has adopted the manufacturer's labelling as his own, it may seem fair that he should have the benefits as well as the burdens of such adoption.¹⁹³ In our view, however, it would be undesirable to elevate the Massachusetts judgment to a proposition of law, and to entrench it in the revised Act. In our *Warranties Report*¹⁹⁴ we rejected the suggestion that, because he is usually only a conduit pipe for the distribution of goods manufactured by others, a retailer should be relieved from compliance with the implied warranties. In that Report, we gave our reasons for this view. We consider these reasons to be just as valid in the case of non-consumer goods sold at retail.

Accordingly, we recommend that the revised Act should not contain a statutory presumption to the effect that a prior seller's disclaimer shall enure in favour of a retailer by whom the goods are resold.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The conditions and warranties implied by section 13 of *The Sale of Goods Act* are generally satisfactory and should, subject to the matters discussed in recommendation No. 2, *infra*, be retained in the revised Act.
2. In order to clarify and modernize the implied warranties and conditions contained in section 13 of the existing Act, the following changes and amendments should be made:
 - (a) Consistent with our earlier recommendation that the distinction between warranties and conditions should be eliminated, the condition of title should be described in the revised Act as a warranty.
 - (b) The revised Act should provide that, where the seller retains a security interest in the goods, his implied warranty of title takes effect when the goods are delivered to the buyer.
 - (c) The revised Act should continue the policy, now contained in section 13(a), that the seller must have a "right", and not merely a "power" to sell the goods.
 - (d) The revised Act should not contain any provision reversing the decision in *Microbeads A.G. v. Vinhurst Road Markings, Ltd.*, [1975] 1 W.L.R. 218 to the effect that the warranty of quiet possession applies not only to acts committed by the seller or otherwise arising before the goods are delivered to the buyer, but has equal application to acts lead-

¹⁹³It should be noted however that *Taylor v. Jacobson* did not, strictly speaking, involve a disclaimer clause. Rather, the question was whether the retailer was entitled to rely on the manufacturer's directions and warnings concerning the use of the product. Other problems suggested by the court's reasoning are discussed in Duesenberg and King, footnote 150 *supra*, pp. 7.52.19-20.

¹⁹⁴*Supra*, footnote 156, pp. 72-73.

ing to a lawful interference with the buyer's quiet possession, that arise after this date.

- (e) Subject to the modifications noted below, section 13(c) of the existing Sale of Goods Act dealing with the warranty of freedom from encumbrances, should be retained in the revised Act:
 - (i) the revised Act should not define the words "charge" or "encumbrance", but should incorporate, in addition to these words, the term "security interest";
 - (ii) the warranty of freedom from encumbrances should be expressed to take effect when the seller delivers the goods to the buyer; accordingly, the revised Act should provide that the goods "will be delivered free from any security interest . . .".
 - (f) The revised Act should not contain a special provision, similar to UCC 2-312(3), relating to patent infringements and the like and restricted to merchant sellers.
 - (g) The revised Act should include a provision, comparable to s. 12(2) of the U.K. *Sale of Goods Act* as amended, which provides for qualified title obligations where it is clear that the seller purports to transfer only a limited title. Disclaimer clauses should not, however, be prohibited; rather, the excludability of the obligations should be governed by the test of unconscionability.
3. The revised Act should contain a provision that corresponds to, but is a revision of, section 14 of the Ontario Sale of Goods Act dealing with the implied condition of description. This provision should make it clear, as does UCC 2-313(1)(b), that a description of goods creates an express warranty that the goods conform to the description.
 4. A provision dealing with sales in a self-service store comparable to section 13(2) of the U.K. *Sale of Goods Act* as amended should be included in the revised Ontario Act.
 5. The revised Act should contain a provision to the effect that, subject to recommendation No. 6, *infra*, a description of the goods given by a third person is binding on the seller, only if by his words or conduct he has adopted the description as his own.
 6. Following UCC 2-314(2)(f), representations or promises appearing on the container, label, or other material accompanying goods should be treated as part of the warranty of merchantability and as such should be binding on merchant sellers.
 7. A statutory definition of the word "description" is unnecessary, but use of the term should be avoided wherever possible.
 8. In order to dispel the impression that the implied warranties and conditions contained in section 15 of the existing Act operate only as limited exceptions to the doctrine of *caveat emptor*, the

preamble to the section should not be reproduced in the revised Act, and the warranties should be expressed in positive terms.

9. Both the warranties of fitness and of merchantability should be retained in the revised Act, but their order of appearance should be reversed.
10. The implied warranties of fitness and merchantability should not be extended to private sales.
11. Subject to the following specific recommendations, the implied condition of merchantability contained in section 15.2 of the existing Sale of Goods Act should be replaced by provisions similar to section 14(2) of the U.K. *Sale of Goods Act* as amended, and should include a definition of merchantability similar to that in section 62(1A) of the U.K. Act.
 - (a) As in section 14(2) of the U.K. Act, the requirement of a sale "by description" as a condition precedent to the operation of the warranty of merchantability should be eliminated.
 - (b) The implied warranty of merchantability should be restricted in the revised Act to cases where the seller is a person who deals in goods of the kind supplied under the contract of sale.
 - (c) The revised Act should not contain a provision, similar to section 14(5) of the amended U.K. Act, to the effect that, where a sale by a private seller is effected through an agent acting in the course of business, the implied terms of merchantable quality and fitness shall apply unless reasonable steps have been taken to inform the buyer that the sale is on behalf of a private seller.
 - (d) The revised Act should contain a definition of "merchantable quality". In order to make it clear that merchantable quality is not restricted to the functional or use value of the goods, the definition of the term, although based on section 62(1A) of the U.K. *Sale of Goods Act* as amended, should contain a reference to the quality and condition of the goods.
 - (e) In order to reverse the result of the decision in *Henry Kendall & Sons v. William Lillico & Sons Ltd.*, [1969] 2 A.C. 31, the definition of merchantable quality, as in section 62(1A) of the amended U.K. Act, should require the goods to be fit for "the one or more purposes for which goods of that kind are commonly bought".
 - (f) The revised Act should make it clear that the warranty of merchantability applies to used, as well as to new, goods.
 - (g) the definition of merchantable quality in the revised Act should require that the goods will remain fit or perform

*The Honourable Richard A. Bell dissents from this recommendation. See, footnote 62, *supra*.

satisfactorily, as the case may be, for a reasonable length of time, having regard to all the circumstances.

- **(h) The implied warranty of merchantability should require that, with respect to new goods, spare parts and repair facilities, where relevant, will be available for a reasonable period of time.
 - (i) Other specifications of merchantability, similar to those contained in clauses (a), (b), (d) and (e) of UCC 2-314(2), should be included in the definition of merchantable quality.
 - (j) With respect to the effect of the buyer's examination of the goods, the revised Act should provide that the warranty of merchantability does not apply,
 - (i) if the buyer has examined the goods before the contract was made, "with respect to any defect that such an examination ought to have revealed"; or
 - (ii) as regards defects specifically drawn to the buyer's attention before the contract was made.
- 12. There should be included in the revised Act a new warranty of fitness, similar to that contained in section 14(3) of the U.K. *Sale of Goods Act* as amended, but restricted to sales by a seller who deals in goods of the kind supplied under the contract of sale.
- 13. The revised Act should not contain a separate section dealing with sales by sample; rather, those portions of section 16 of the existing *Sale of Goods Act* that retain their utility should be absorbed in other provisions of the revised Act.
- 14. In the revised Act, the provision comparable to section 16(2)(c) of the existing Act should correct the anomaly under the present section, whereby the condition of merchantability is made applicable whether or not the seller is a merchant with respect to the goods.
- 15. The implied warranties in a lease of goods should be clarified and, with the exceptions of the implied warranties of title and freedom from encumbrances, the obligations of a lessor under a true lease of goods should be assimilated to those of a seller under a contract of sale of goods. Accordingly, the revised Act should provide:
 - (a) that the provisions relating to express warranties and the implied warranties of description, merchantability and fitness apply to a contract for the lease of goods; and
 - (b) that, in addition, the lessor warrants,
 - (i) that he has the right to lease the goods; and
 - (ii) that the lessee will have quiet possession of the goods during the period of the lease.
- 16. In order to provide constructional guidance where the express

**The Honourable J. C. McRuer and Mr. W. Gibson Gray dissent in part from this recommendation. See, footnote 98, *supra*.

and implied terms of a contract of sale appear to be in conflict, a provision comparable to UCC 2-317 dealing with cumulation and conflict of express and implied warranties should be adopted in the revised Act in place of section 15.4 of the existing Act.

- ***17. Clauses excluding or restricting the statutory warranties implied in the buyer's favour and the buyer's remedies for breach of the seller's statutory warranties, should not be prohibited in commercial sales; rather, such disclaimer clauses should be permitted, subject to the doctrine of unconscionability. The revised Act should contain an explicit provision to this effect.
- 18. A provision, similar to UCC 2-316(1), dealing with construction of contractual terms that tend to limit or negate an express warranty, should be included in the revised Act. This new provision should not, however, contain any reference to the parol evidence rule.
- 19. Provisions similar to UCC 2-316(2) and (3)(a), which provide specific guidelines concerning the manner and circumstances in which the implied warranties may be excluded or modified, should not be included in the revised Act.
- 20. The revised Act should contain a provision, similar to UCC 2-719(3), deeming an exclusion or limitation of damages for breach of warranty to be *prima facie* unconscionable in the case of injury to the person, but not in the case of economic loss. Unlike UCC 2-719(3), however, the provision in the revised Act should not be limited to injury to the person caused by consumer goods, but should embrace injury to the person caused by any type of goods.
- 21. The revised Act should not contain a provision prohibiting disclaimer clauses that purport to exclude liability for all negligent acts; rather, such clauses should be controlled by the general provision on unconscionability.
- 22. With respect to disclaimer clauses in non-privity cases, there should be included in the revised Act a provision to the effect that the provisions of the Act on disclaimer clauses should apply to an express representation or promise made by a manufacturer or distributor not in privity with the subsequent buyer,
 - (a) where the modification, limitation or exclusion comes to the buyer's attention before he acts in reliance upon the representation or promise; or
 - (b) where, in the case of a representation or promise made to the public, the buyer may reasonably be expected to learn of the modification, limitation or exclusion before buying the goods or relying upon the representation or promise.
- 23. The revised Act should not contain a statutory presumption to the effect that a prior seller's disclaimer shall enure in favour of a retailer by whom the goods are resold.

***The Honourable Richard A. Bell dissents in part from this recommendation. See, footnote 165, *supra*.

CHAPTER 10

EXPRESS AND IMPLIED WARRANTIES AND THE DOCTRINE OF PRIVITY

1. THE GENERAL ISSUE

The preceding chapter concerned itself with two topics: namely, the statutory warranties implied by law in the buyer's favour under a contract of sale; and, the effectiveness of disclaimer clauses excluding or restricting the seller's liability for breach of express and implied warranties. The important question that we consider in the present chapter is whether a warranty, express or implied, given by a seller to his buyer, should enure in favour of a third party to whom the goods are resold by the buyer. The most familiar example of this phenomenon is reflected in the typical retail setting: the retailer acquires the goods from the manufacturer or distributor and resells them to his customer. If the goods prove defective, the retail buyer will have his warranty remedies against the retailer, unless they have been successfully excluded, and the retailer in turn will have similar rights against the manufacturer or distributor. The critical question is whether the retail customer should be permitted to sue the manufacturer or distributor directly for breach of warranty, thereby, if he wishes, bypassing the retailer completely. The same question will arise in any other vertical relationship in which the goods have passed through successive hands, and a subsequent buyer seeks to sue a prior seller for breach of warranty.

Existing law would answer this question in terms of the doctrine of privity of contract. Assume that A, a manufacturer, sells goods to B, a retail seller. Assume also that B sells the goods to C, a customer, and that the goods prove defective. Since C was not a party to the contract of sale between A and B, A has breached no warranty obligations owing to C, and C's recourse remains limited to an action against B. If the defective goods have harmed C or his property, and A is found to have been negligent, C may have a remedy in tort under the doctrine of *Donoghue v. Stevenson*;¹ this possibility, however, has no bearing on A's warranty liability. Anglo-Canadian law recognizes an apparent exception to this basic doctrine where A has issued an express warranty in C's favour. It is, however, not a real exception since, even in such cases, A's liability is based on the concept of a collateral contract between the two parties. We have dealt with this question in an earlier chapter² and have recommended that express warranty should be defined in the revised Act so as to embrace representations and promises made by a remote seller in favour of a subsequent buyer. We need not, therefore, pursue this matter again. It is necessary, however, to distinguish this situation from the situation in which a prior seller, A, makes an express representation concerning, for example, the authenticity of a painting, to his immediate buyer, B. If B sells the goods to a subsequent buyer, C, the question

¹[1932] A.C. 562 (H.L.).

²Supra, ch. 6, sec. A.

arises whether C should be able to sue A in respect of the express warranty given by A to B. Our recommended draft provision deals with this issue.

The other vital issue that remains is whether the "citadel of privity" should also be breached so as to enable C to sue A for breach of implied warranty. We examined this issue in the consumer context in our *Report on Consumer Warranties and Guarantees*.³ We recommended⁴ that a manufacturer of consumer goods should be deemed to give a consumer buyer implied warranties of the same type as the statutory warranties that run from the retailer to the consumer buyer, and that the manufacturer should be subject to the same remedies in an action by the consumer buyer as would the retailer. These recommendations would have been substantially implemented by Bill 110,⁵ and are fully reflected in Saskatchewan in *The Consumer Products Warranties Act*.⁶ Our recommendations in the *Warranties Report* were confined to consumer transactions, and we expressed no views on the desirability of extending them to non-consumer sales. This is the question to which we now turn our attention.

Before presenting the several arguments on both sides of the line, one crucial distinction must be noted at the outset. As described in the *Warranties Report*,⁷ the great majority of American courts impose on a manufacturer and other persons forming part of the distributive chain liability for defective goods causing injury to person or property. This liability is imposed either on a tort basis, or on a theory of implied warranties running from the manufacturer to the injured party. We may conveniently refer to these cases as products liability cases. We recognize, as we already recognized in our *Warranties Report*,⁸ that defective products that cause injury to person or property fall into a separate category, and that they raise a different range of issues. They are, therefore, substantially excluded from the following discussion, particularly since we have embarked on a separate study of this branch of the law.⁹ Our primary concern is with defective goods that cause economic losses, although, as will be apparent from our draft provision,¹⁰ our tentative view is that a person who suffers damage by reason of a defective product should have, in ad-

³Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), ch. 5.

⁴Ibid., pp. 76-77.

⁵See, *The Consumer Products Warranties Act, 1976*, introduced by Bill 110, 3rd Session, 30th Legislature (Ont.), ss. 3(2), 4, 5, and 7(2). Excluded were the statutory warranty of fitness [s. 6] and the warranties applicable in a sale by sample [s. 3(2)(a)]. Bill 110 was not enacted. See, also, *The Ontario New Home Warranties Plan Act*, S.O. 1976, c. 52, ss. 13, 14, for a more circumscribed example of legislation breaching traditional doctrines of privity.

⁶S.S. 1976-77, c. 15, ss. 13-14. See now, also, the *New Brunswick Consumer Product Warranty and Liability Act*, S.N.B. 1978, c. C-18.1, s. 23.

⁷Supra, footnote 3, pp. 67-69. See, also, Waddams, *Products Liability* (1974), ch. 12.

⁸Ibid., p. 71.

⁹For the past two years, the Commission has been engaged in a study of the law governing products liability. The Products Liability Project is being carried out under the directorship of Professor Stephen M. Waddams of the Faculty of Law, University of Toronto.

¹⁰See, Draft Bill, s. 5.18(1)(c) and (2). See, also, *infra*, this ch., sec. 3(f).

dition to any rights he may have in tort, the right to recover in respect of all types of injury, including injury to the person or property, for breach of warranty. The issues relating to economic loss caused by defective goods have been extensively canvassed in American case law¹¹ and in scholarly literature.¹² The availability of these sources considerably simplifies our task of presenting the arguments both in favour of and in opposition to the extension of warranty liability.¹³

The following arguments have been marshalled by way of opposition to an extension of warranty liability:

(a) There is a vital difference between holding a manufacturer responsible to an ultimate consumer for a defective product causing personal injury or damage to other property, and imposing warranty liability for a defective product that only results in an economic loss.¹⁴ Liability in the first case is based on broad grounds of public policy: that is, the manufacturer's superior ability to absorb such losses; the desirability of internalizing the cost of product accidents; and, the deterrent effect of a doctrine of strict liability. These arguments do not hold true for defective products resulting in economic losses, at least so far as they involve non-consumer goods.

(b) Since Anglo-Canadian law has so far shown a strong reluctance to permit recovery for pure economic losses resulting from negligent acts,¹⁵ other than under the *Hedley Byrne* doctrine,¹⁶ it would be anomalous to single out the distribution of defective products for special treatment.

¹¹See, for example, *Santor v. A. M. Karagheusian, Inc.* (1965), 207 A. 2d 305 (N.J. Sup. Ct.); *Seeley v. White Motor Co.* (1965), 403 P. 2d 145 (Cal. Sup. Ct.) *Morrow v. New Moon Homes, Inc.* (1976), 548 P. 2d 279 (Alaska Sup. Ct.). The *Morrow* case considers all the intervening developments.

¹²See, for example, White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), s. 11-5 at p. 334; Note, "Economic Loss in Products Liability Jurisprudence" (1966), 66 Colum. L. Rev. 917 at pp. 964-65; Comment, "The Vexing Problem of the Purely Economic Loss in Products Liability: An Injury in Search of a Remedy" (1972), 4 Seton Hall L. Rev. 145, 154; Annot., "Privity of Contract as Essential in an Action Against Remote Manufacturer or Distributor for Defects in Goods Not Causing Injury to Person or Other Property" (1967), 16 A.L.R. 3d 683, 687.

¹³Reference should also be made to the important Quebec jurisprudential developments as reflected in the recent decision of the Supreme Court of Canada in *General Motors Products of Canada Ltd. v. Leonis Kravitz* (January 23, 1979, as yet unreported), and the earlier authorities cited therein. French law also recognizes an "action directe" by the ultimate buyer against the manufacturer of a defective product: see Amos & Walton, *Introduction to French Law* (3rd ed., 1967), pp. 362-63.

¹⁴Compare, Chief Justice Traynor's majority judgment in *Seeley v. White Motor Co.* (1965), 403 P. 2d 145 (Cal. Sup. Ct.), at pp. 151-52.

¹⁵See, *inter alia*, the extended discussions in *Rivtow Marine Ltd. v. Washington Iron Works*, [1974] S.C.R. 1189, (1972), 40 D.L.R. (3d) 530 (S.C.C.); *S.C.M. (U.K.) Ltd. v. W. J. Whittal & Son Ltd.*, [1971] 1 Q.B. 337 (C.A.); Atiyah, "Negligence and Economic Loss" (1967), 83 L.Q.R. 248.

¹⁶*Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465 (H.L.), appl'd in Canada, *inter alia*, in *Haig v. Bamford*, [1977] 1 S.C.R. 466, (1975), 72 D.L.R. (3d) 68 (S.C.C.).

(c) Imposing liability on a manufacturer for defective products causing only economic losses would enormously extend the scope of his enterprise risks, in terms of both amount of claims and number of potential claimants. Such an imposition would make it difficult for a manufacturer to estimate his costs accurately, especially if consequential damages were also allowed.

(d) The manufacturer would find it very difficult to procure insurance to cover such liability.

(e) At least in the case of commercial transactions, the buyer is in a better position to assess the consequences to him of a defective product. If he is sufficiently concerned, he can seek specific guarantees from the retailer or manufacturer or procure his own insurance against consequential losses.

The arguments supporting the extension of warranty liability proceed from the following premises:

(a) In the case of many finished products, the position of the non-consumer buyer is not very different from that of the consumer buyer: in both cases, the buyer relies heavily on the manufacturer's reputation, and the manufacturer, in turn, aims much of his advertising directly at the ultimate buyer. In both cases, the retailer is often little more than a conduit pipe for the manufacturer's product. It is artificial, therefore, to rely on privity notions to measure the scope of the manufacturer's implied warranties; sheltering behind the doctrine merely conceals the real nature of the problem.

(b) The distinction between express and implied warranties is often a fine one. Both historically and functionally, they frequently merge into one another. This is true, for example, of the warranty of description, which the courts have treated both as an express and implied warranty.¹⁷ It is also true of the implied warranty of merchantability, which is merely a judicial extrapolation of the warranty of description.¹⁸

(c) It is artificial to distinguish between economic losses and other types of loss, because it is often accidental whether a defective product causes one or other type of loss, or both. Moreover, economic losses can be as serious for a subsequent buyer as losses resulting from physical harm.¹⁹ At best, the distinction is only relevant in determining the validity of a manufacturer's disclaimer clause.

(d) Negligence law is an inappropriate analogy, since it seeks to protect a much wider range of persons and applies to almost any type of activity. Warranty liability has always been governed by its own principles. The difficulty of insuring against economic losses

¹⁷Compare, *Andrews Bros. Ltd. v. Singer & Co. Ltd.*, [1934] 1 K.B. 17 (C.A.).

¹⁸See, for example, the judgment of Mellor, J., in *Jones v. Just* (1868), L.R. 3 Q.B. 197, at pp. 205, 207.

¹⁹See the dissenting judgment of Peters, J., in *Seeley v. White Motor Co.*, footnote 11 *supra*, at p. 155.

arises just as often in claims by the immediate buyer against the manufacturer. The extension of the scope of the manufacturer's liability involves, therefore, only a change in quantity, and not in kind. Moreover, the dangers of untoward liability can be avoided by careful legislative draftsmanship, and by permitting a manufacturer to rely on a disclaimer clause accompanying the goods or forming part of the contract of sale between him and his immediate buyer, where such a clause would otherwise be unobjectionable.²⁰

(e) To deny the ultimate buyer a right of recourse against the manufacturer may sometimes deny him *any* remedy; for example, where the immediate seller is not worth suing, or has become bankrupt or gone out of business. These are, in fact, the most important reasons for a buyer seeking to pursue a manufacturer because of defective goods.

(f) Permitting direct action against the manufacturer will avoid circuity of actions and expedite the settlement of legitimate claims.

2. OUR OWN POSITION

The Commission supports in principle the desirability of extending the express and implied warranties of a seller in favour of a subsequent buyer. After careful deliberation, however, we have decided not to take a firm position on the issue at this time, but to postpone a final decision until interested parties have had an opportunity to express their views. We adopt this position primarily because of the novelty and importance of the issue in Ontario, and because of the absence of hard data on the probable impact of such an extension of warranty liability. The only precedent in Canada appears to be the farm implement and agricultural machinery legislation in the Prairie Provinces and Prince Edward Island.²¹ These are useful guides if one is considering an incremental approach, but they provide little assistance in seeking to assess the impact of a general change in warranty law.

There appears to be an equal paucity of precedents in other common law jurisdictions. American law is still in a state of flux. We noted in our *Warranties Report*,²² the decision of the New Jersey Supreme Court in *Santor v. A. & M. Karagheusian, Inc.*²³ In that case, the Court extended the concept of tortious liability for personal injury and physical damage caused by a defective product to purely economic losses in the case of consumer goods. This extension was disapproved in the majority judgments of the Supreme Court of California in *Seeley v. White Motor Co.*,²⁴

²⁰This solution would answer the problem that troubled Lord Reid in *Young & Marten Ltd. v. McManus Childs Ltd.*, [1969] 1 A.C. 454 (H.L.), 467, in contemplating the possibility of the purchaser of a new home being permitted to sue directly the manufacturer of defective roofing tiles.

²¹See, *Report on Consumer Warranties and Guarantees in the Sale of Goods*, footnote 3 *supra*, pp. 96 *et seq.*

²²*Ibid.*, p. 68.

²³(1965), 207 A. 2d 305 (N.J. Sup. Ct.).

²⁴(1965), 403 P. 2d 145 (Cal. Sup. Ct.).

and has been rejected by the majority of other courts.²⁵ American courts have been equally divided with respect to whether the remote seller can be sued on a theory of implied warranty running with the goods. On the strength of the recent decision of the Supreme Court of Alaska in *Morrow v. New Moon Homes, Inc.*,²⁶ there appears, however, to be a trend in favour of allowing consumer claims, subject to the usual defences available to a seller under the *Uniform Commercial Code*. The question of the manufacturer's liability to the ultimate buyer in non-consumer transactions remains at large.

Finally, reference should be made to the important recommendations in the New South Wales *Working Paper on The Sale of Goods*.²⁷ This Working Paper, basing itself in part on our *Warranties Report*, recommended²⁸ extending the warranty of merchantable quality in favour of a remote buyer, but without confining it to consumer goods. The remote buyer's claim would, however, generally be subject to any defence that would have been available to the remote seller in an action for breach of warranty by the immediate buyer. We consider other aspects of the New South Wales recommendations more fully below.

3. DRAFT PROVISION AND CONSEQUENTIAL ISSUES

While we have decided to postpone a final recommendation, we have thought it useful to insert a tentative provision in the Draft Bill. We do so in order to focus attention both on the main issue and on the many consequential issues that would arise for decision if it were decided to permit direct warranty recovery against a prior seller.

Our recommended draft provision is contained in section 5.18 of the Draft Bill, and reads as follows:

(1) In this section

(a) 'goods' includes goods that have been converted into, in-

²⁵For example, *Bright v. Goodyear Tire & Rubber Co.* (1972), 463 F. 2d 240 (9th Cir.); in this case, there was no recovery from the manufacturer for a defective tire when no physical injury was alleged; *Eli Lilly & Co. v. Casey* (1971), 472 S.W. 2d 598 (Tex. Civ. App.); in this case, a buyer of a weed control chemical was held not entitled to recover economic loss from the manufacturer. Also, see *Melody Home Mfg. Co. v. Morrison* (1970), 455 S.W. 2d 825 (Tex. Civ. App.); *Rhodes Pharmacal Co. v. Continental Can Co.* (1966), 219 N.E. 2d 726 (Ill. C.A.); *Price v. Gatlin* (1965), 405 P. 2d 502 (Ore. Sup. Ct.); *Koellmer v. Chrysler Motors Corp.* (1970), 276 A. 2d 807 (Conn. Cir.); *General Motors Corp. v. Halco Instruments, Inc.* (1971), 185 S.E. 2d 619 (Ga. Ct. App.).

²⁶(1976), 548 P. 2d 279 (Ala. Sup. Ct.). See, also, *Lynne Carol Fashions, Inc. v. Cranston Print Works Co.* (1972), 453 F. 2d 1177 (3rd Cir.); *Gherna v. Ford Motor Co.* (1966), 246 Cal. App. 2d 639; *Manheim v. Ford Motor Co.* (1967), 201 So. 2d 440 (Fla.); *Hoskins v. Jackson Grain Co.* (1953), 63 So. 2d 514 (Fla.); *Spence v. Three Rivers Builders & Masonry Supply, Inc.* (1958), 90 N.W. 2d 873 (Mich.); *Ford Motor Co. v. Grimes* (1966), 408 S.W. 2d 313 (Tex. Civ. App.).

²⁷Law Reform Commission, New South Wales, *Working Paper on The Sale of Goods* (1975).

²⁸*Ibid.*, Recommendations 15.12-15.15; and New South Wales Draft Bill, Part IIA, ss. 20H to 20L.

corporated in, or attached to, other goods or that have been incorporated in or attached to land;

- (b) 'immediate buyer' means a buyer who buys goods from a prior seller;
 - (c) 'injury' means injury to the person, damage to property, or any economic loss;
 - (d) 'prior seller' means a seller who sells goods that are subsequently resold;
 - (e) 'subsequent buyer' means a buyer who buys goods that have previously been sold by a prior seller to an immediate buyer.
- (2) Without prejudice to a subsequent buyer's rights under section 5.10, a prior seller's warranty, express or implied, and any remedies for breach thereof, enure in favour of any subsequent buyer of the goods who suffers injury because of a breach of the warranty.
- (3) A subsequent buyer's rights under subsection 2 are subject to any defence that would have been available to such prior seller in an action against him for breach of the same warranty by his immediate buyer.
- (4) The measure of damages recoverable by a subsequent buyer for breach of warranty by a prior seller shall be no greater than the damages that the immediate buyer could have recovered from such prior seller if a successful claim had been brought against the immediate buyer by the subsequent buyer for breach of the same warranty and the immediate buyer had made a claim over against the prior seller.
- (5) This section applies notwithstanding any agreement to the contrary.

Subsection (2) establishes the basic principle, and was inspired by the comparable, but not identical, language in UCC 2-318²⁹ and sections 20I(2) and 20K(2) of the New South Wales Draft Bill.³⁰ The expression "enure in favour of" suggests that the warranty rights of the subsequent buyer are derivative, and this theory is consistent with the defences open to the prior seller pursuant to subsection (3). However, this conceptualization of the buyer's right may be regarded by some as unduly restrictive.

²⁹UCC 2-318, Alternatives A, B and C, all begin with the phrase, "A seller's warranty whether express or implied extends to . . .". Apparently, none of the alternatives, as so far construed by American courts, includes simple claims for economic losses. See, further, *Report on Consumer Warranties and Guarantees in the Sale of Goods*, footnote 3 *supra*, pp. 68-69.

³⁰These sections provide as follows:

Section 20I(2)

A warranty of merchantable quality enures for the benefit of a remote buyer.

Section 20K(2)

A warranty of title enures for the benefit of a remote buyer.

It may be preferable to base the buyer's rights on a simple theory of implied warranties running directly from the prior seller. We return to this point below. The other consequential issues raised by the draft section are as follows.

(a) TYPES OF SELLER

Our draft provision draws no distinction between merchant and non-merchant sellers, or between manufacturers and other types of merchant-sellers. We believe this to be the better approach. The prior seller whom it is sought to reach will usually be a merchant seller, but this will not always be true; for example, where a subsequent buyer complains of breach of the warranty of title committed by the prior seller of a motor vehicle.³¹ Like the New South Wales Draft Bill, our provision is designed to embrace all members of the distributive chain, and to leave it to them to sort out liability among themselves. It would, no doubt, be possible to restrict the definition of "prior seller" to the manufacturer, but this approach, as was noted in the *Warranties Report*,³² would create difficult problems of definition.

(b) TYPES OF SUBSEQUENT BUYER AND MEMBERS OF BUYER'S HOUSEHOLD

As in the case of sellers, we would draw no distinction between the different types of buyer. Even if Ontario adopts consumer products warranties legislation, there will be no harm in continuing to include consumer buyers in the warranty provisions of the revised Sale of Goods Act.³³ The New South Wales provisions also extend protection to members of an immediate or remote buyer's household in the case of claims for breach of the warranty of merchantability,³⁴ thus breaching the walls of horizontal as well as vertical privity. While such a provision may be entirely appropriate in a Consumer Products Warranties Act,³⁵ or in a statute dealing generally with products liability claims, we entertain doubts about the wisdom of including it in a revised Sales Act whose primary concern is with the rights of buyers. Accordingly our draft section does not deal with questions of horizontal privity.

(c) TYPES OF PRODUCT

Once again, our draft provision draws no distinction. We have

³¹Compare, *Oscar Chess Ltd. v. Williams*, [1957] 1 All E.R. 325 (C.A.). Compare, also, *Beale v. Taylor*, [1967] 3 All E.R. 253 (C.A.); the case involved misdescription of a motor vehicle as the result of a "transplant" of part of the body performed by an earlier owner.

³²*Supra*, footnote 3, p. 72.

³³Although in the case of conflict the consumer warranty provision would presumably prevail.

³⁴Law Reform Commission, New South Wales, *Working Paper on The Sale of Goods* (1975), Draft Bill, s. 20I(3). Section 20J also extends the benefit of the implied warranty of fitness, but apparently only to members of the household of the immediate buyer.

³⁵See, *Report on Consumer Warranties and Guarantees in the Sale of Goods*, footnote 3 *supra*, ch. 5.2.

considered the possibility of restricting the prior seller's liability to finished goods, or to goods intended to reach the subsequent buyer in the condition in which they left the prior seller. In our view, however, such a restriction would not be desirable. If the question at issue is whether the goods were defective at the time they left the prior seller's hands, it seems to us that it ought not to matter whether the goods were in a processed or unprocessed form,³⁶ or whether they consisted of components or accessories intended to be installed in other goods.³⁷ Such distinctions could create serious anomalies and substantially reduce the value of a provision similar to section 5.18 of the Draft Bill.³⁸

This question should not be confused with a very different issue: namely, whether the prior seller should be held accountable for an unauthorized or unexpected use or description of the product, made or given by the person to whom it was sold or by some other person in the distributive cycle. The answer to this question should clearly be no. The fundamental theory of the draft provision is that the prior seller is only responsible for defects in the goods that existed at the time that they left him.

(d) TYPES OF WARRANTIES

We have already discussed the context in which express warranties will be relevant, and we now consider to what extent the draft provision should distinguish between various types of implied warranties. Unlike the New South Wales draft, our provision does not distinguish between the various implied warranties that enure in favour of a subsequent buyer. The New South Wales Working Paper³⁹ excludes the warranty of fitness. The authors did not envisage circumstances in which it could apply between the prior seller and a subsequent buyer, unless the subsequent buyer communicated his special needs directly to the prior seller. In such a case, they reasoned, the subsequent buyer could sue the prior seller for breach of express warranty. The notion that the ultimate buyer may not wish, or be able, to invoke the implied warranty of fitness seems to us a dubious assumption, and one that is not consistent with the broad meaning attached to the warranty of fitness in recent decisions.⁴⁰ In any event, whether or not this warranty applies will turn on the particular

³⁶Compare, *Henry Kendall & Sons v. William Lillico & Sons Ltd.*, [1969] 2 A.C. 31 (H.L.).

³⁷In the case of motor vehicles, it is not unusual for the vehicle manufacturer to exclude warranty responsibility for designated accessories (for example, tires) and to remit the retail buyer to the warranties given by the accessory manufacturer. See, further, *Report on Consumer Warranties and Guarantees in the Sale of Goods*, footnote 3 *supra*, pp. 84-85.

³⁸Assume A, a retail buyer, purchases a truck from dealer, B. The truck is assembled by C and includes tires manufactured by D. If the tires are defective, it would be anomalous if A could sue B and C, but not D. It would be equally anomalous if B, upon being sued by A, were not able to join D as a third party. In both cases, the consequences could be serious if C is insolvent or no longer in business.

³⁹*Supra*, footnote 34, para. 6.51(b).

⁴⁰See, especially, *Christopher Hill Ltd. v. Ashington Piggeries Ltd.*, [1972] A.C. 441 (H.L.).

facts of a case. The fact that the implied warranty of fitness may not apply in all circumstances is not, in our view, a sufficient justification for excluding the warranty entirely. The same observation holds true of the other implied warranties.

(e) BUYER'S REMEDIES FOR BREACH OF WARRANTY

Section 20L(1) of the New South Wales Draft Bill restricts the buyer's remedies against a prior seller to an action for damages. This suggests that, as against the prior seller, the buyer will not be entitled to reject the goods, however defective, even though he would have been entitled to reject the goods vis-à-vis his immediate seller.⁴¹ This could give rise to an anomalous position. The buyer, upon rejection, would be entitled to sue his immediate seller for total failure of consideration. Section 20L(1) would, however, remit him to a claim for damages against the prior seller, which presumably would be assessed on the footing that the buyer, being unable to reject the goods,⁴² still had the goods. There may, of course, be many circumstances where it is too late for the buyer to reject the goods; for example, where the goods have changed their character, or have been processed or transformed since leaving the original seller's possession. This is not the same as saying that no right of rejection should exist at any time.⁴³ Subsection (2) of our draft provision does not attempt to spell out the subsequent buyer's remedies against the prior seller. It leaves these remedies to be worked out by analogy to the remedies available against the immediate seller, and in light of the overall objective of the section to avoid circuity of actions.

(f) TYPES OF INJURY

Here again, our draft provision draws no distinction between the types of claim maintainable against the prior seller, and those maintainable against the immediate seller. This position seems to us desirable in the interests of evenhanded treatment of immediate and prior sellers. Under existing law, under the rule in *Hadley v. Baxendale*,⁴⁴ the buyer of a defective product is entitled to recover from his seller all substantially foreseeable damages, direct or consequential, whether they arise out of the diminished value of the goods, loss of bargain, or injury to person or property. It would be anomalous, in our opinion, if the prior seller's liability towards the subsequent buyer were to be measured by a lower standard than his liability towards the immediate seller.

⁴¹Compare, *Reece v. Yeager Ford Sales Inc.* (1971), 184 S.E. 2d 727 (W.Va. Sup.Ct.App.); and *Emmons v. Durable Mobile Homes Inc.* (1974), 521 S.W. 2d 153 (Tex. Civ. App.).

⁴²The position would become still more complicated if the immediate seller also purported to reject the goods.

⁴³A right of rejection in favour of the subsequent buyer was recognized in *General Motors Products of Canada Ltd. v. Leonis Kravitz*, footnote 13 *supra*. While the decision was based on Quebec law, the reasoning that led the Supreme Court of Canada to this conclusion is equally apposite in a common law context.

⁴⁴(1854), 9 Exch. 341, as qualified by *The Heron II*, [1969] 1 A.C. 350 (H.L.).

This would be particularly true if consequential damages were not recoverable from the prior seller, even though he had not sought to restrict his liability by a disclaimer clause. The following example illustrates our reasoning. A farmer purchases seed from a local distributor which, owing to a defect, fails to germinate. He sues both the distributor and the producer claiming direct and consequential losses. The distributor joins the producer as a third party. The farmer is successful in his suit against the distributor, and the distributor is successful in his claim over against the producer. Ignoring the impact of any disclaimer clauses, the producer's liability to the distributor will be governed by the same damage principles as obtain between the farmer and the distributor. There would, therefore, be little point in limiting the farmer's potential recovery against the producer to direct damages, since this would not protect the producer against the distributor's higher claim. In our view, the accidents of litigation should not affect the basic principles governing an assessment of damages against the prior seller.⁴⁵

(g) RESTRICTIONS BINDING ON THE BUYER

Our preceding remarks have no bearing on whether the prior seller should be entitled to restrict, or even exclude entirely, his warranty liability to a subsequent buyer. Consistently with the general theoretical framework of the draft provision, we are firmly of the view that his position should be no worse than if he were in direct privity with the subsequent buyer. The question that has troubled us considerably is how this goal is best achieved.

There are at least two possible models. One is to make the subsequent buyer's claim subject to any disclaimer clause by the prior seller or to other special circumstances⁴⁶ surrounding the original sale, provided that reasonable steps have been taken to bring the disclaimer clause or such circumstances to the subsequent buyer's attention prior to, or at the time of, his purchase.⁴⁷ The other, and much broader, approach is to make the subsequent buyer's claim subject to all, or most of, the defences that could have been raised if an action against the prior seller had been brought by the immediate buyer who purchased the goods from the prior seller. It seems to us that both models have their strengths and weaknesses.

The second model is the model adopted in the New South Wales Working Paper, and adopted also in section 5.18(3) of our Draft Bill

⁴⁵The danger of the prior seller being held responsible for consequential damages has been repeatedly stressed by American scholars, and has even influenced those courts that favour lifting the privity barrier in consumer claims. In *Morrow v. New Moon Homes, Inc.*, footnote 11 *supra*, at p. 292, n. 42, the Court was careful to reserve its position on the admissibility of claims for consequential losses. The fact that the manufacturers would be exposed to the same danger in a "vouching over" action by the buyer from him, seems to be frequently overlooked.

⁴⁶For example, defects disclosed to the first buyer or goods sold to him as "seconds".

⁴⁷Compare, the *Morrow* case, footnote 11 *supra*, at p. 292.

for purposes of discussion.⁴⁸ There is, however, a difference between the New South Wales draft provision⁴⁹ and the provision we have tentatively put forth. The New South Wales provision excludes from the available defences "any agreement, release or other thing made or done, or judgment obtained or suffered" between the prior seller and his immediate buyer, or other intermediate party, subsequent to the original contract of sale between the prior seller and the immediate buyer; our provision, on the other hand imposes no such restriction. In our tentative view, the New South Wales provision tips the balance too far in favour of the subsequent buyer. We recognize, however, that this, too, is a troublesome question that will require further consideration if it is decided to adopt a provision similar to section 5.18.⁵⁰

Both of the models that we have discussed appear to have advantages and disadvantages. The strength of the first model is that it proceeds from a theory of implied warranties that run directly from the prior seller to the subsequent buyer undisturbed by all the complexities of the relationship between the prior seller and his buyer. Its weakness resides in the fact that it may not be possible, in many instances, for the prior seller to give effective notice to the subsequent buyer of disclaimer clauses or other special circumstances affecting the distribution of the goods. Fairly detailed rules would be necessary to clarify the position. The advantage of the second model adopted by New South Wales and by this Commission in its tentative draft provision is that it avoids these difficulties by proceeding from a theory of derivative rights. This provides maximum certainty and predictability from the prior seller's point of view, and, in particular, protects him against the danger of being mulcted in heavy damages by an indeterminate number of subsequent buyers. Its weakness lies in the fact that it puts the subsequent buyer completely at the mercy of a contractual relationship to which he is not a party.

We do not suggest that the choice between these two models is clear and obvious. We are, however, persuaded, at least at this stage, that the approach adopted by the New South Wales Working Paper, and reflected in our draft provision, is preferable. Our own view is that if the main proposition — the right of a subsequent buyer to sue a prior seller for breach of warranty — is accepted as sound, then it should not be too difficult to find a compromise solution on the scope of the prior seller's defences.

⁴⁸Quebec law, as expounded in *General Motors Products of Canada Ltd. v. Leonis Kravitz*, footnote 13 *supra*, appears to contemplate both possibilities.

⁴⁹Section 20L(2)(b).

⁵⁰The issue is not as simple as it looks. Obviously, settlements reached in bad faith should not be binding on a subsequent buyer; but what of good faith settlements? Suppose, after receiving the goods and before any resale, the first buyer complains about their quality and the claim is settled by the prior seller, allowing an abatement on the price. The buyer then resells the goods without disclosing the defect. Fairness suggests that the prior seller's position should be the same as if the first buyer knew of the defect in quality before he received the goods.

(h) OTHER CONSEQUENTIAL ISSUES

The New South Wales Working Paper⁵¹ touches on a number of other consequential issues of a procedural character. In our view, these and others can be safely deferred to a later date pending agreement on the question of principle.

⁵¹*Supra*, footnote 34, paras. 7.15-7.16; Draft Bill, s. 20L(2).

PART V

TRANSFER OF PROPERTY (TITLE) IN GOODS

INTRODUCTION

This part of the Report will deal with two important facets of property rights and their incidents arising out of the contract of sale. The first involves the time and impact of the transfer of title on the rights of the parties *inter se*. The second focuses on the question whether the buyer can acquire a better title to the goods than the seller himself had. A plea of confession and avoidance is in order. Because of the pivotal role played by the concept of title in the existing law, it is customary, indeed inevitable, to link this concept with the important consequences that flow from a transfer of title. As will be seen, the Code departs radically from this approach and, generally speaking, the parties' rights are not dependent on the situs of title under the Code. For the purpose of the ensuing discussion it seems convenient, however, to deal with the two approaches under the same rubric. The existing Ontario Act uses "property" when referring to the rights and duties of the parties *inter se*,¹ and "title" in the context of the sections² stating the exceptions to the rule that a seller cannot transfer a better title than he himself has.³ The Code does not observe this distinction, but uses title throughout. In the discussion that follows, and unless otherwise indicated, "property" and "title" are used interchangeably to convey the same meaning.

¹See, for example, *The Sale of Goods Act*, R.S.O. 1970, c. 421, ss. 2(1), 13(a), 17-19, 21, 47(1).

²*Ibid.*, ss. 22-25; and see, also, s. 46(2).

³The significance of the distinction is a matter of controversy. See, Battersby and Preston, "The Concepts of 'Property', 'Title' and 'Owner' used in the Sale of Goods Act 1893" (1972), 35 Mod. L. Rev. 268.

CHAPTER 11

TRANSFER OF TITLE AND ITS INCIDENTS BETWEEN SELLER AND BUYER

1. DEFECTS IN EXISTING LAW

The focal role occupied by property concepts in traditional sales law is hardly surprising,¹ since the overriding purpose of a contract of sale is to transfer the general property in goods from the seller to the buyer.² Its importance, moreover, is greatly enhanced in existing Anglo-Canadian law in two respects. First, there are the rules in the Act dealing with the following matters: namely, the transfer of risk;³ the right to payment of the price;⁴ the right to reject specific goods;⁵ and, the seller's rights of resale and the measurement of damages.⁶ These rules are presumptively linked to, or affected by, the locus of title. Secondly, there is the much broader range of non-sales rules whose operative effect turns on the same question. Examples are as follows: namely, the existence of an insurable interest;⁷ the right to replevy⁸ or to claim goods in bankruptcy;⁹ the right to sue third parties in conversion and for injury to the goods;¹⁰ exigibility of goods by execution;¹¹ exposure to various forms of taxation;¹² liability as "owner" under motor vehicle acts;¹³ and, criminal liability under a variety of penal or regulatory statutes.¹⁴ A sales act cannot be expected to regulate all the non-sales incidents of transfer of title, but it may well be asked, as it has been asked,¹⁵ what features the questions of risk, price, rejection, and rights of resale have in common that cause them to be governed by the same metaphysical abstraction.

¹For a general discussion of transfer of title and its incidents between seller and buyer, see, Crawford, "Property in Goods, Incidence and Consequences", Research Paper No. IV. 1.

²*The Sale of Goods Act*, R.S.O. 1970, c. 421, s. 2(1).

³S. 21.

⁴S. 47.

⁵S. 12(3).

⁶Ss. 38(1)(c), 46.

⁷See, *The Insurance Act*, R.S.O. 1970, c. 224, s. 122, stat. cond. 2.

⁸*Smith v. Billard* (1922), 55 N.S.R. 502 (C.A.); *Haverson v. Smith* (1906), 16 Man. R. 204 (K.B.).

⁹See, for example, *In re Wait*, [1927] 1 Ch. 606 (C.A.); and, compare, *Carlos Federspiel & Co. S.A. v. Charles Twigg & Co. Ltd.*, [1957] 1 Lloyd's Rep. 240 (Q.B.).

¹⁰*Haverson v. Smith*, footnote 8 *supra*; *McGregor v. Whalen* (1914), 31 O.L.R. 543, 20 D.L.R. 489 (C.A.); *Zaiser v. Jesske*, [1918] 3 W.W.R. 757 (Sask. C.A.); *Benjamin's Sale of Goods* (1974), para. 293; *Jarvis v. Williams*, [1955] 1 All E.R. 108 (C.A.).

¹¹For example, *Johnson v. Logan* (1889), 32 N.S.R. 28 (C.A.).

¹²See, *Steel Co. of Canada Ltd. v. R.*, [1955] S.C.R. 161 (S.C.C.).

¹³For example, *The Highway Traffic Act*, R.S.O. 1970, c. 202, s. 147.

¹⁴*R. v. Thomas*, [1928] 2 W.W.R. 608 (Alta. S.C., App. Div.); *R. v. Chappus* (1920), 48 O.L.R. 189, 55 D.L.R. 77 (H.C.J.).

¹⁵Llewellyn, "Through Title to Contract and a Bit Beyond" (1937-38), 15 N.Y.U.L.Q. Rev. 159; and, compare, Crawford, footnote 1 *supra*, pp. 1-3.

The picture is further complicated. The rules adopted by the Ontario Sale of Goods Act to determine the time of transfer of title are so complex, and frequently turn on such highly subjective factors, that accurate prediction of the outcome of a litigated issue is well nigh impossible, and incongruous results may well occur. The existing Sale of Goods Act proceeds from two basic principles, and then elaborates a series of presumptive rules to assist the court in discharging its task. The overriding principles are contained in sections 17 and 18 of the existing Act, and may be stated in this way. First, title cannot pass before the goods have been ascertained.¹⁶ Secondly, where there is a contract for the sale of specific or ascertained goods, the parties' own intentions govern as to the time of transfer.¹⁷

If a different intention has not been manifested (and many contracts are silent on the question) then the presumptive rules in section 19 of the Act, relating to the intention of the parties as to the time at which the property in the goods is to pass, come into play.¹⁸ These rules are no-

¹⁶*The Sale of Goods Act*, R.S.O. 1970, c. 421, s. 17. This section provides as follows:

17. Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer until the goods are ascertained.

¹⁷*Ibid.*, s. 18. This section reads as follows:

18(1) Where there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.

(2) For the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.

¹⁸Section 19 reads as follows:

19. Unless a different intention appears, the following are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer:

Rule 1.—Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made and it is immaterial whether the time of payment or the time of delivery or both is postponed.

Rule 2.—Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof.

Rule 3.—Where there is a contract for the sale of specific goods in a deliverable state but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.

Rule 4.—When goods are delivered to the buyer on approval or 'on sale or return' or other similar terms, the property therein passes to the buyer:

- (i) when he signifies his approval or acceptance to the seller or does any other act adopting the transaction;
- (ii) if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time, and what is a reasonable time is a question of fact.

toriously difficult to apply and, not surprisingly, different courts have often reached different results on substantially similar facts. The difficulties are particularly acute in the case of a contract involving the sale of future or unascertained goods. In such a case, in one set of circumstances, the presumptive rule in section 19, Rule 5(i) of the Act requires the court to inquire not only whether goods of the correct "description" and in a "deliverable state" were "unconditionally" appropriated to the contract, but also whether the buyer gave his "assent" to the appropriation and whether the assent was "express" or "implied".¹⁹ The resulting confusion was aptly described by Lord Cresswell in a judgment written more than a century ago.²⁰ This description remains very relevant today. Lord Cresswell stated:

It is impossible to examine the decisions on this subject without being struck by the ingenuity with which sellers have contended that the property in goods contracted for had, or had not, become vested in the buyers, according as it suited their interest; and buyers, or their representatives, have, with equal ingenuity, endeavoured to show that they had, or had not, acquired the property in that for which they contracted; and Judges have not unnaturally appeared anxious to find reasons for giving a judgment which seemed to them most consistent with natural justice. Under such circumstances, it cannot occasion much surprise if some of the numerous reported decisions have been made to depend upon very nice and subtle distinctions, and if some of them should not appear altogether reconcilable with each other.²¹

If the courts manipulate the rules to achieve equitable results, would it not be simpler, it may well be asked, to achieve the same results by providing issue oriented rules that are not geared to an elusive "title"?

A further group of difficulties arises from the failure of the Act to distinguish between a reservation of title by the seller before the goods have been delivered to the buyer, and those situations in which the seller

Rule 5.—

- (i) Where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer, or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer, and such assent may be expressed or implied and may be given either before or after the appropriation is made.
- (ii) Where in pursuance of the contract the seller delivers the goods to the buyer or to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer and does not reserve the right of disposal, he shall be deemed to have unconditionally appropriated the goods to the contract.

¹⁹See, the analysis of these requirements in *Benjamin's Sale of Goods* (1974), paras. 349 *et seq.*

²⁰*Gilmour v. Supple* (1858), XI Moore 551, 556, 14 E.R. 803, 809 (P.C.).

²¹For a similar statement, see *Jerome v. Clements Motor Sales Ltd.*, [1958] O.R. 738, (1958), 15 D.L.R. (2d) 689 (C.A.), *per Laidlaw, J.A.*, at 15 D.L.R. (2d) 690.

reserves title after delivery to secure payment of the price. Only recently, with the adoption of *The Personal Property Security Act*,²² has this anomaly been removed.²³ It may well be, however, that part of this anomaly continues to survive in cases where a bill of lading is issued in the seller's favour after shipment of the goods, and before the bill is endorsed to the buyer.²⁴

2. THE CODE APPROACH²⁵

Karl Llewellyn, the chief reporter of the Code, was sharply critical of these defects in the U.K. and American sales Acts. In a celebrated article written by him before the War,²⁶ he contended, first, that the "lump" concept of title should be abandoned in favour of an issue oriented approach and, secondly, that the revised rules should be applied to easily and objectively ascertainable sets of facts. Article 2 clearly bears the imprint of these views. The preamble to section 2-401 declares in part:

Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title.

Llewellyn's first goal, the abandonment of title in favour of an issue oriented approach, is emphasized in this provision and is reflected in subsequent sections dealing with matters that include the following: special property and insurable interests;²⁷ right to claim or recover goods on insolvency;²⁸ transfer of risk;²⁹ right to reject and revocation of acceptance;³⁰ and, seller's right to sue for the price.³¹ The more important of these will be examined presently. It is important to note, however, that the concept of title has not disappeared from Article 2; it has been de-

²²R.S.O. 1970, c. 344 as am., especially s. 2(a)(i) and s. 1(y).

²³Under prior law, it was usually held, *inter alia*, that risk remained with the seller unless the agreement provided otherwise: see, for example, *Killoran v. Monticello State Bank*, [1920] 3 W.W.R. 17 (Alta. S.C., Tr. Div.) rev'd on other grounds [1920] 3 W.W.R. 542 (App. Div.), and aff'd (1921), 61 S.C.R. 528 (S.C.C.). *The Personal Property Security Act* does not expressly overrule these cases, but their reversal is necessarily implicit in the concept that a conditional seller merely retains a security interest in the goods, once the goods have been delivered to the buyer. See, also, Weir, "Risk in Conditional Sale Agreements" (1929), 7 Can. Bar Rev. 744, reprinted in (1942-45), 5 Alta. L.Q. 19.

²⁴See, *infra*, ch. 14, sec. A.3(c).

²⁵The literature is substantial. See, among others, White & Summers, *Handbook of the Law Under the Uniform Commercial Code* (1972), pp. 134 *et seq*; Duesenberg and King, *Sales and Bulk Transfers Under the Uniform Commercial Code*, Bender's Uniform Commercial Code Service, Vol. 3A, chapters 8 and 10; Latty, "Sales and Title and the Proposed Code" (1951), 16 L. & Contem. Prob. 3; Duesenberg, "Title: Risk of Loss and Third Parties" (1965), 30 Mo. L. Rev. 191.

²⁶*Supra*, footnote 15. See, also, his evidence before the New York Law Revision Commission, quoted in White & Summers, *supra*, pp. 136-37.

²⁷UCC 2-501.

²⁸UCC 2-502, 2-702.

²⁹UCC 2-509, 2-510.

³⁰UCC 2-601, 2-608.

³¹UCC 2-709.

moted, but not disinherited, and will continue to play a significant role in numerous situations not governed by express Code provisions.³² The other goal for which Llewellyn strove, the adumbration of easily observable physical facts as the basis for the application of issue oriented rules, is exemplified in sections 2-501, 2-509, and 2-401. We agree, as do members of the Research Team,³³ that the Code approach on both these matters is sound, and should be adopted in the revised Ontario Act.³⁴ We are fortified in our conclusion by the fact that the Code approach has also been applied in the Hague Uniform Law³⁵ and in the 1977 draft UNCITRAL Convention³⁶ in determining the rights of the parties *inter se*. As will be seen, however, we do not subscribe to all the Code provisions implementing the new policies, nor to the language in which they are expressed.

Some of the relevant Code provisions will now be examined more fully, both to illustrate the important conceptual departures from existing Anglo-Canadian law, and to draw attention to a number of possible difficulties.

(a) SPECIAL PROPERTY AND INSURABLE INTEREST

Section 2-501 provides as follows:

2-501.(1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are non-conforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs

- (a) when the contract is made if it is for the sale of goods already existing and identified;

³²See, UCC 2-401.

³³See, Crawford, footnote 1 *supra*, especially at p. 48.

³⁴See, for example, Draft Bill, s. 6.1(1).

³⁵See, Uniform Law on The International Sale of Goods, Arts. 96-101, especially Arts. 96 and 97, which read as follows:

Article 96

Where the risk has passed to the buyer, he shall pay the price notwithstanding the loss or deterioration of the goods, unless this is due to the act of the seller or of some other person for whose conduct the seller is responsible.

Article 97

1. The risk shall pass to the buyer when delivery of the goods is effected in accordance with the provisions of the contract and the present Law.

2. In the case of the handing over of goods which are not in conformity with the contract, the risk shall pass to the buyer from the moment when the handing over has, apart from the lack of conformity, been effected in accordance with the provisions of the contract and of the present Law, where the buyer has neither declared the contract avoided nor required goods in replacement.

³⁶See, UNCITRAL, *Report on Tenth Session* (1977), General Assembly, Official Records: Thirty-Second Session, Supp. No. 17, (A/32/17), Arts. 64-68, especially Arts. 64 and 65.

- (b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers;
 - (c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest season after contracting whichever is longer.
- (2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him and where the identification is by the seller alone he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.
- (3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

This section has no counterpart in *The Sale of Goods Act* although, in a loose sense, it could be described as a miniature title provision. "Special property", under the Code, is a necessary ingredient in the following cases: namely, the buyer's right to claim goods on the seller's insolvency;³⁷ the exercise of the right to replevy;³⁸ or, the right to sue third parties for injury to the goods.³⁹ Several features are noteworthy. First, the statutory rules of identification apply unless the parties have explicitly adopted different rules. This requirement sensibly eliminates the traditional search for the parties' implied intention, sanctioned in section 18 of the present Ontario Act. Secondly, identification can occur without the buyer's consent. This sharply distinguishes the Code concept from the concept of appropriation in section 19, Rule 5, of the Ontario Act; and for good reason, since identification enures for the buyer's benefit and does not, *qua* buyer, impose on him any burdens under section 2-501.⁴⁰ Thirdly, the seller's identification need not be irrevocable, again an important point of departure from the existing law. Fourthly, identification does not require either that the goods be in a deliverable condition, or the completion of other steps necessary to determine the price. In this respect, too, section 2-501 is greatly superior to the rules in section 19 of *The Sale of Goods Act*. We are persuaded by the merits of these features and recommend adoption in the revised Act of a provision comparable to UCC 2-501.⁴¹

It will be observed that, in the case of a contract involving future crops or the unborn young of animals, special time limitations are prescribed by UCC 2-501(1)(c). The presumptive rules only apply if the contract is for the young of animals to be born within twelve months of

³⁷UCC 2-502.

³⁸UCC 2-716(3).

³⁹UCC 2-722.

⁴⁰It does not, for example, affect the time of transfer of risk, or the buyer's liability to pay the price: see, UCC 2-501, Comment 4.

⁴¹See, Draft Bill, s. 7.1.

the contract, or, for crops that are to be harvested within twelve months of the contract or the next normal harvest season, whichever is longer. These restrictions were designed to protect farmers and have a long history.⁴² Until the adoption of *The Personal Property Security Act* they had no counterpart in Ontario legislation. Our attention has not been drawn to abuses involving long term contracts of this nature. However, the one year limitation has been copied in section 13(2)(a) of *The Personal Property Security Act* and, for the sake of consistency, we recommend retention of the same restrictions in the revised Sale of Goods Act.

(b) BUYER'S RIGHT TO GOODS ON SELLER'S INSOLVENCY

Section 2-502 provides as follows:

2-502.(1) Subject to subsection (2) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

The implications of this section are examined more fully in chapter 17. Suffice it to say at this juncture that the buyer's rights are so narrowly circumscribed that they are of little practical importance. Moreover, it is doubtful whether Ontario could, constitutionally, adopt a similar provision.

(c) RISK OF LOSS

(i) General Observations

Multiple hazards can accompany goods between the time of their identification to the contract and the time of their actual receipt by the buyer. This possibility has led to the adoption of rules governing the location of the risk of loss that go back at least to Roman times.⁴³

Risk rules and rules of frustration intersect; but they are not the same. Unless otherwise provided, a frustrating event discharges both parties from further obligations under the contract. This result does not, however, necessarily follow from loss of, or damage to, the goods. If risk

⁴²See, Gilmore, *Security Interests in Personal Property* (1965), Vol. II, secs. 32.1-32.3, pp. 857-63. Also, see, Coates, *Law and Practice in Chattel Secured Farm Credit* (1954); and Note, "Mortgages on Future Crops as Security for Government Loans" (1937), 47 Yale L.J. 98. One concern was the ability of the farmer to obtain financing for current crops if a prior crop mortgagee might have an interest beyond the crop for which he specifically gave financing.

⁴³Buckland, *A Textbook of Roman Law* (3rd rev. ed., 1963), pp. 486-87 *et seq.*; Lawson, "The Passing of Property and Risk in Sale of Goods — A Comparative Study" (1949), 65 L.Q.R. 352, 354.

of loss at the material time lies with the buyer, he remains liable for the price; obviously, the contract is not discharged so far as he is concerned. Conversely, if the risk is with the seller, the buyer will be excused from further obligations, but whether the seller will also be relieved will turn on other factors. In this Report, therefore, it will be convenient to postpone discussion of frustration problems to a later chapter.⁴⁴

Four basic tests have been adopted by different legal systems to determine the time when risk of loss passes from the seller to the buyer.⁴⁵ According to these tests, risk passes as follows: (a) when the contract is concluded; (b) when title in the goods is transferred; (c) when the seller has delivered the goods, actually or constructively; and, (d) when the buyer has actually received the goods. Roman law was the source of the first test. It is a test that survives in a substantial number of civil law jurisdictions, including Switzerland, the Netherlands, Japan and members of the Latin American legal system. The title or property test⁴⁶ has been adopted in France, among other jurisdictions. This test was also part of the common law,⁴⁷ and was codified in the U.K. *Sale of Goods Act, 1893*. It is reproduced in section 21 of the Ontario Act.⁴⁸ The "delivery" test is in force in the Scandinavian countries and, as will be seen, has been substantially adopted in the *Uniform Commercial Code*. The fourth test, the one that turns on transfer of possession, obtains under German and Austrian law, and under the laws of various Eastern European countries. An important aspect of it also appears in the Code.

If one groups together, as others have done,⁴⁹ the first two and the last two tests, it will be seen that there are only two basic tests: namely, those that turn upon identification and appropriation of the goods to the contract, and those that apply a delivery or control test.

The title test adopted by the common law is difficult to justify functionally. It may seem reasonable to argue that the party in whom ownership is vested at the material time should also assume the risks incident

⁴⁴*Infra*, ch. 15.

⁴⁵*International Encyclopedia of Comparative Law* (January, 1969), Vol. 6, ch. 3, Model Section on "The Time of the Passing of Risk", paras. 511 *et seq.* Lagergren, *Delivery of the Goods and Transfer of Property and Risk in the Law of Sale: A Comparative Study* (Stockholm, 1954).

⁴⁶*Res perit domino* (a phrase used to express the rule that, when something is lost or destroyed, the owner bears the loss or destruction).

⁴⁷*Martineau v. Kitching* (1872), L.R. 7 Q.B. 436, 454 *per* Blackburn, J.

⁴⁸Section 21 reads as follows:

Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but, when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not, but,

- (a) when delivery has been delayed through the fault of either the buyer or seller, the goods are at the risk of the party in fault as regards any loss that might not have occurred but for such fault; and
- (b) nothing in this section affects the duties or liabilities of either seller or buyer as a bailee of the goods of the other party.

⁴⁹*International Encyclopedia of Comparative Law*, footnote 45 *supra*, para. 532, pp. 14-15.

to ownership. However, as has also been observed of the Roman test,⁵⁰ it shows little concern for practical considerations. The title test ignores insurance factors; it disregards the fact that the party in possession of the goods is best able to ensure their safekeeping and to determine the cause of an accident; and, it overlooks the fact that, until the seller has delivered the goods, he has not completed his contractual obligations. A strict application of the title test leads to anomalous results that run counter to the expectations of practical persons.⁵¹ It would greatly surprise a consumer buyer, and no doubt his seller, to be told that, by selecting a particular item on the seller's floor for subsequent delivery to his home, he could be deemed to have assumed the risk forthwith.⁵² Conversely, a seller would find it difficult to understand why, following delivery, the risk of loss should remain with him simply because he retained title until payment of the price. These difficulties have not gone unobserved. In overseas shipment contracts, the business community long ago rejected the title test by the adoption of trade terms, such as "f.o.b." and "c.i.f.". These terms transfer the risk of loss to the buyer when the goods are delivered to the carrier, regardless of the locus of title.⁵³ The courts, too, carved out an important exception in the case of the sale of a part of a larger bulk of goods in storage that is accompanied by the transfer of a delivery

⁵⁰"On the whole, the theory of transfer of risk upon the conclusion of the contract is a venerable dogma which has been developed and handed down to the present days with little concern for practical considerations; it belongs to the legal inventory inherited from former generations which in many places is preserved in name but used only with caution in cases of practical importance": *ibid.*, para. 532, p. 15.

⁵¹Compare, Atiyah, *The Sale of Goods* (5th ed., 1975), pp. 168-69.

⁵²"Certainly in practice retailers ignore the rules about risk for reasons of consumer good-will": Cranston, *Consumers and the Law* (1978), p. 171.

⁵³For f.o.b. contracts, see *Benjamin's Sale of Goods* (1974), para. 1704, citing *inter alia*, *Stock v. Inglis* (1884), 12 Q.B.D. 564, at pp. 573, 575, 577; on appeal (1885), 10 App. Cas. 263 (H.L.), 273; and, *The Parchim*, [1918] A.C. 157, 168 (P.C.). The risk may remain on the seller after shipment where he has failed to perform his obligations under section 31 of *The Sale of Goods Act*: *Benjamin's Sale of Goods* (1974), para. 1707; or it may pass to the buyer before shipment where delivery is delayed through his fault: *ibid.*, para. 1708. For c.i.f. contracts, see *Benjamin's Sale of Goods* (1974), para. 1562, citing the leading case of *The Julia*, [1949] A.C. 293 (H.L.), 309, that risk passes generally "on shipment or as from shipment". See, also, *E. Clemens Horst Co. Ltd. v. Biddell Bros.*, [1911] 1 K.B. 934, at pp. 956, 959; *Law & Bonar Ltd. v. British American Tobacco Co.*, [1916] 2 K.B. 605. Where goods to be shipped are paid for before shipment, it may be that risk passes before shipment as well: *Wiehe v. Dennis Bros.* (1913), 29 T.L.R. 250 (K.B.), *per* Scrutton, J. The American principles are much the same. While UCC sections 2-319 and 2-320 provide ancillary clarifications of the locus of risk, the general rules contained in section 2-509 still apply. Risk will generally pass on shipment unless the contract is f.o.b. destination. These usual terms yield to a contrary indication in the contract of sale itself: *National Heater Co. v. Corrigan Co. Mechanical Contractors* (1973), 482 F. 2d 87 (8th Cir.). Likewise, as in English law, risk may pass before shipment where the buyer's fault causes the delay in shipment: *Multiplastics Inc. v. Arch Industries* (1974), 14 U.C.C. Rep. 573 (Conn. Sup. Ct.).

warrant.⁵⁴ Technically, there is no transfer of title in such a case, since no particular part of the bulk has been appropriated to the contract; nevertheless, in the interests of mercantile convenience, the courts found an implied intention that risk was to pass upon delivery of the warrant.

These exceptions demonstrate the fundamental weakness of the title test and the superiority of the delivery test. As has been observed,⁵⁵ the "passing of risk upon actual delivery is the modern solution. It conforms with commercial views and practices; it has been adopted by the more recent national and international codifications". The *Uniform Commercial Code*, too, has adopted the "modern" solution.

This solution is contained in section 2-509, which reads as follows:

2-509.(1) Where the contract requires or authorizes the seller to ship the goods by carrier

- (a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (Section 2-505); but
- (b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer

- (a) on his receipt of a negotiable document of title covering the goods; or
- (b) on acknowledgment by the bailee of the buyer's right to possession of the goods; or
- (c) after his receipt of a non-negotiable document of title or other written direction to deliver, as provided in subsection (4)(b) of Section 2-503.

(3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery.

(4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this Article on sale on approval (Section 2-327) and on effect of breach on risk of loss (Section 2-510).

⁵⁴Benjamin's *Sale of Goods* (1974), para. 404; *Sterns Ltd. v. Vickers Ltd.*, [1923] 1 K.B. 78, dist'd in *Comptoir d'Achat v. Luis de Ridder Limitada*, [1949] A.C. 293 (H.L.). Compare, *Inglis v. James Richardson & Sons Ltd.* (1913), 29 O.L.R. 229, 14 D.L.R. 137 (C.A.).

⁵⁵*International Encyclopedia of Comparative Law*, footnote 45 *supra*, para. 532, p. 15.

The first three subsections of section 2-509 distinguish between three types of situation. The first involves contracts that require or authorize the seller to ship the goods by independent carrier ("shipment contracts"). Here, the risk passes to the buyer when the goods are delivered to the carrier, unless the seller is required to deliver them at a particular destination ("destination contracts"). In the latter event, risk passes when the goods are there duly tendered while in the hands of the carrier. The second type of situation concerns goods in the hands of a bailee that are to be delivered without being moved. Here, risk of loss passes upon the buyer's receipt of a document of title or acknowledgement by the bailee of the buyer's right to possession. Finally, in cases not falling within the preceding rules, risk of loss passes to the buyer upon his receipt of the goods, if the seller is a merchant, and, if he is not, upon tender of delivery. It should be noted that, by virtue of section 2-509(4), the provisions of subsections (1), (2) and (3) are subject, *inter alia*, to contrary agreement of the parties.

It will be observed that a common thread runs throughout these rules: that is, the transfer of possession of the goods from the seller to the buyer, or a tender thereof. The situs of title plays no role whatever. It has been said⁵⁶ that section 2-509 has been very successful in its objectives and that, unlike pre-Code law, it has generated very little litigation. We support the general philosophy of section 2-509 and recommend the adoption of a comparable provision in the revised Act.⁵⁷ There, are however, a number of clarifications and changes that should be made in the Ontario version of the section to which we must now turn our attention.

(ii) *Issues Arising out of Section 2-509 and Related Questions*⁵⁸

(1) *Shipment Contracts*

We recommend strengthening the language of subsection (1)(a) to make it clear that a "shipment" contract is the normal type of contract, and "destination" contract the variant type.⁵⁹ This clarification would bring subsection (1)(a) into conformity with the draftsman's intentions.⁶⁰ In our view, the word "duly" should also be deleted in "duly delivered" and "duly tendered" in subsections (1)(a) and (b), since its retention would lead to anomalous results. We interpret "duly" to mean in "accordance with the terms of the contract". That being so, any deviation, however inconsequential, would prevent the risk of loss passing to the buyer. This result would conflict with the principle we have previously recommended, that the revised Act should distinguish between substantial and non-substantial breaches for the purpose of determining the parties'

⁵⁶White & Summers, footnote 25 *supra*, p. 137.

⁵⁷See, Draft Bill, s. 7.8.

⁵⁸For American discussions of the Code's risk rules, see *inter alia* White & Summers, footnote 25 *supra*, pp. 134-66; Duesenberg and King, footnote 25 *supra*, ch. 8; Foorman, "Risk of Loss Under Section 2-509 of the California Uniform Commercial Code" (1973), 20 U.C.L.A. L. Rev. 1352; and, Williams, "Risk of Loss Under the Uniform Commercial Code" (1974), 7 Ind. L. Rev. 711.

⁵⁹See, Draft Bill, s. 7.8(1)1.

⁶⁰See, UCC 2-503, Comment 5.

remedies. We see no justification for applying a stricter test where the goods suffer casualty. It may also be noted that a literal rendering of "duly" in section 2-509 is inconsistent with the provisions of sections 2-504 and 2-510.⁶¹

"Carrier" is not defined in Article 2. It is clear, however,⁶² that the term does not include the seller's own transportation facilities; whether it includes the Post Office appears to be undecided,⁶³ although in principle there is no reason why it should not.⁶⁴ We do not deem it necessary to define this term.

We have also been troubled about the practical implications of applying section 2-509(1)(a) to sales where the buyer is a non-merchant. Assume A, a non-merchant in Vancouver, orders a newly published book from a firm of publishers in Toronto. Assume, also, that the book is lost in transit. Who should bear the risk of loss? If the agreement contains no provision to the contrary, the contract may be deemed a "shipment" contract and the risk will lie with the non-merchant buyer, assuming the seller has made a proper contract of carriage with the seller. It is doubtful that the buyer would appreciate this result, and even more doubtful that he would carry insurance against such risks.⁶⁵ The problem does not appear to be discussed in the standard Anglo-Canadian or American textbooks. Our inquiries have shown that some large retail stores and other merchants with a mail order practice will not hold buyers responsible for risk of loss in transit. This policy, however, is based on the commendable grounds of fairness and good public relations, and not on the obligations implied by sales law. In any event, we have no reason to believe that this practice is universally followed by retail sellers.⁶⁶ We deem it desirable, therefore, to deal directly with the matter. We recommend that a provision be added to the revised Act⁶⁷ to make it clear that, where the seller is a merchant and the buyer is not, risk passes when the goods are tendered to the buyer at their destination. In other words, in such a case, the presumptive rule applicable to shipment contracts will not apply. It will, of course, be open to the parties to adopt a different rule; but we think it better that the burden of shifting the risk of loss should be upon the merchant than upon the buyer.

⁶¹Compare, Duesenberg and King, footnote 25 *supra*, p. 8-53. The authors appear to equate "duly" with the buyer's rights of rejection and transfer of risk in UCC 2-510(1).

⁶²White & Summers, footnote 25 *supra*, pp. 143-44.

⁶³*Ibid.*

⁶⁴Compare, *Badische Anilin and Soda Fabrik v. Basle Chemical Works*, [1898] A.C. 200 (H.L.).

⁶⁵Under existing law, except in the case of c.i.f. contracts, there would appear to be no general obligation on the shipper to obtain insurance for the buyer's benefit: see, *Benjamin's Sale of Goods* (1974), para. 595. Nor is such an obligation explicitly imposed on the seller under UCC 2-504. Even if the shipper were obliged to insure for the buyer's benefit, the consumer would still be put to the trouble of making a claim under the policy. In our view, the merchant seller is usually much better equipped to handle such claims.

⁶⁶Indeed, we have been given some examples to the contrary.

⁶⁷See, Draft Bill, s. 7.8(1), rule 1(c).

A very different problem raised by shipment contracts, and not covered by UCC 2-509, involves sales made while goods are already afloat or in transit. If the goods are damaged or lost in transit, it may be difficult to ascertain the date of the casualty for the purpose of allocating the risk of loss. Article 66 of the 1977 draft UNCITRAL Convention⁶⁸ resolves this difficulty by providing that, in such cases, the risk is assumed by the buyer from the time the goods were handed over to the carrier who issued the documents controlling their disposition, unless at the time of the conclusion of the contract the seller knew or ought to have known that the goods had suffered casualty and failed to disclose this fact to the buyer.

We are not aware of any Anglo-Canadian case law in which the problem has been discussed.⁶⁹ It seems clear that the Code draftsman rejected the UNCITRAL approach.⁷⁰ Our own view is that, since the issue is one of first impression in Canada and does not appear to have given rise to practical difficulties, it would be premature to offer a legislative solution to it at this time.

(2) Meaning of "Bailee"

Prior to the decision in *Caudle v. Sherrard Motor Co.*,⁷¹ there was some modest doubt as to whether a seller could ever be treated as a bailee for the purposes of subsection (2) of UCC 2-509. In the *Caudle* case, the Texas Civil Court of Appeals held that the subsection was only intended to apply to a "common law commercial bailee", such as a warehouseman. The requirement of a "commercial" bailee appears, at least in part, to add an unjustifiable gloss; but the requirement of an independent bailee is consistent with the underlying rationale of subsection (2). We therefore recommend that the provision comparable to UCC 2-509(2) adopted in the revised Act should make it clear that the provision only applies to goods held by a bailee "other than the seller".⁷²

(3) UCC 2-509(3)

This subsection raises two major issues. The first arises from the distinction that it draws between a merchant seller and a non-merchant seller. The second involves the question whether a merchant seller should remain at risk for an indefinite period; that is, until actual "receipt" of the goods by the buyer.

So far as the first issue is concerned, the rationale of the distinction

⁶⁸A comparable rule appears in ULIS, Art. 99(1).

⁶⁹The question does not appear to be discussed in the standard Anglo-Canadian texts. The assumed facts occurred in *Couturier v. Hastie* (1856), 5 H.L.C. 673 (H.L.), but the case was decided on different grounds. See, further, Berman and Kaufman, "The Law of International Commercial Transaction (*Lex Mercatoria*)" (1978), 19 Harv. Int. L. Rev. 221, at pp. 241-43. (We are indebted to Mr. Eric Bergsten, Senior Legal Officer of the International Trade Law Branch of the United Nations, for drawing our attention to the latter discussion.)

⁷⁰UCC 2-509, Comment 2.

⁷¹(1975), 525 S.W. 2d 238 (Tex. Civ. App.).

⁷²See, Draft Bill, s. 7.8(1), rule 2.

appears to be⁷³ that a merchant seller may be expected to insure the goods, whereas no such assumption can be made in the case of a non-merchant seller. This reasoning overlooks the fact that the seller still has control over the goods, and that it is more likely that he will be insured than a non-merchant buyer. It may be that the problem does not admit of a simple answer, and that a new rule should be devised that would take into consideration the parties' insurance coverage. Until such time, we are of the view that no distinction should be drawn in this context between merchant and non-merchant sellers. Accordingly, we recommend that the provision comparable to UCC 2-509(3) adopted in the revised Act should provide that, whether or not the seller is a merchant, risk of loss shall pass to the buyer upon receipt of the goods.⁷⁴ It should be emphasized that this does not mean that the non-merchant seller will remain at risk indefinitely. Like the merchant seller he will have the benefit of UCC 2-510(3);⁷⁵ hence, once the buyer is in default, the risk of loss will lie with the buyer for a reasonable period, to the extent of any deficiency in the seller's insurance.

The second issue raises a difficult and, as yet, unanswered point of construction of subsection (3).⁷⁶ Suppose A buys a horse from farmer B, pays him for it, and asks him to look after the horse until the following spring.⁷⁷ Does the risk of loss remain with the farmer in the meantime because the buyer is not in actual "receipt" of the goods under UCC 2-509(3)? Would it make a difference if the farmer received separate compensation for his services? It is tempting to argue that, because the farmer has clearly become a bailee of the horse,⁷⁸ UCC 2-509(3) should cease to apply. This would ignore the requirement under subsection (3) of actual receipt of the goods by the buyer before the risk is deemed to pass. However, there is no reason why the buyer could not be considered to have waived actual receipt of the goods, or why, independently of such a waiver, the court could not infer from the facts an intention by the parties not to be governed by UCC 2-509(3). Since so much will turn on the facts of individual cases, we think the problem is best left for judicial resolution. We recommend, therefore, that the revised Act should not contain a specific provision to deal with this problem.

(4) Duties as Bailee of Goods

Section 21(b) of *The Sale of Goods Act* states that the provisions on the transfer of risk shall not affect the duties or liabilities of seller or buyer as a bailee of the goods of the other. The Code does not contain a similar provision, although the opinion has been expressed⁷⁹ that bailment principles will continue to apply where the goods are in the possession of

⁷³UCC 2-509, Comment 3.

⁷⁴See, Draft Bill, s. 7.8(1), rule 3.

⁷⁵See, *infra*, sec. 2(d)(iii).

⁷⁶See, White & Summers, footnote 25 *supra*, pp. 145-46.

⁷⁷The example is based on *Courtin v. Sharp* (1960), 280 F. 2d 345, a pre-Code case, discussed in White & Summers, footnote 25 *supra*, at pp. 144-45, and 146.

⁷⁸UCC 2-509(2) would not apply in such a case, as that provision envisages goods in the hands of the bailee that are to be delivered without being moved.

⁷⁹See, White & Summers, footnote 25 *supra*, p. 149.

one party and title and risk of loss are in the other. We recommend that the revised Act should contain a provision comparable to Section 21(b) of the existing Act.⁸⁰

(5) *Deterioration of Goods in Transit*

Section 32 of the Ontario Sale of Goods Act deals with the question of deterioration of goods in the course of transit. The section provides as follows:

32. Where the seller of goods agrees to deliver them at his own risk at a place other than that where they are when sold, the buyer nevertheless, unless otherwise agreed, takes any risk of deterioration in the goods necessarily incident to the course of transit.

As Benjamin notes,⁸¹ the interpretation of this section gives rise to many difficulties, although the problem to which it addresses itself is of relatively small importance in overseas sales. The Code has no corresponding provision. A principal difficulty about the section is that, in the case of perishable goods, and possibly other goods as well, it appears to conflict with the seller's obligation under the implied condition of fitness to deliver goods that will remain fit for the duration of the journey and for a reasonable period thereafter.⁸² The state of the art may be such that, no matter how careful the seller, deterioration in transit cannot be avoided. Perhaps this is all that section 32 means to convey. In any event, we think the question is one of proper interpretation of the seller's warranty obligations, and that it is best treated under this heading. In our view, section 32 could safely be omitted from the revised Ontario Act, and we so recommend.

(d) RISK OF LOSS — EFFECT OF PARTY'S BREACH (UCC 2-510)

The question to be considered under this heading is the extent to which a party's breach should affect the normal rules for the transfer of risk. The existing Act, in section 21(a),⁸³ only deals with the effect of delay by the buyer or seller in receiving or making delivery of the goods. The effect of other types of breach must be gleaned from general principles of sales law.⁸⁴ UCC 2-510 addresses itself more systematically to the question and provides the following series of rules:

2-510.(1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.

⁸⁰See, Draft Bill, s. 7.8(2).

⁸¹Benjamin's *Sale of Goods* (1974), paras. 1435 *et seq.* Compare, Sassoon, "Damage Resulting from Natural Decay Under Insurance, Carriage, and Sale of Goods Contracts" (1965), 28 Mod. L. Rev. 180, especially at pp. 189-92.

⁸²Mash & Murrell, Ltd. v. Jos. I. Emanuel, Ltd., [1961] 1 All E.R. 485 (Q.B.), rev'd on other grounds [1962] 1 All E.R. 77 (C.A.). Compare, *Oleificio Zucchi S. p. A. v. Northern Sales*, [1965] 2 Lloyd's Rep. 496 (Q.B.), at pp. 517, 518.

⁸³Supra, footnote 48.

⁸⁴Benjamin's *Sale of Goods* (1974), paras. 415-16; Sealey, "‘Risk’ in the Law of Sale", [1972B] 31 Camb. L. J. 225, at pp. 242 *et seq.*

(2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.

It has been said⁸⁵ that at least part of the section conflicts with the policy of UCC 2-509 that the risk should lie with the person in possession, and that the draftsmen have provided no reason for departing from this rule. Whether this criticism is justified is debatable; but the section at least has the merit of being substantially consistent with existing Anglo-Canadian law. It will be convenient to consider separately the rules embraced in the three subsections.

(i) *Delivery of Non-Conforming Goods*

It seems reasonably clear under present law that, where the buyer has rightfully rejected the goods, risk of loss remains in or reverts to the seller. This is so, either on the basis that title never passed, or that it revested in the seller on rejection.⁸⁶ Presumably, the same reasoning would be applied where risk has passed to the buyer and the goods have suffered casualty before the buyer has had an opportunity to reject them.⁸⁷ If this assumption is made, there is nothing novel about subsection (1), which clearly embraces both types of case.

(ii) *UCC 2-510(2)*

Unlike the Code,⁸⁸ *The Sale of Goods Act* does not recognize the buyer's right to revoke his acceptance. If, however, one accepts the soundness of the concept, as we do,⁸⁹ it is reasonable that the goods should revert to the seller's risk after revocation. It will be noted that, under UCC 2-510(2), the revocation is retroactive in character, although it is not clear⁹⁰ what the Code means by the words "from the beginning" in the subsection. Presumably, they mean that the risk may be treated as having rested with the seller from the time of acceptance. Retroactivity may seem harsh, but it is no more onerous than holding the seller at risk for non-conforming goods that were never accepted by the buyer, although subject to his control. It will be noted, moreover, that the risk only reverts

⁸⁵White & Summers, footnote 25 *supra*, p. 147.

⁸⁶Compare, *Kwei Tek Chao v. British Traders & Shippers Ltd.*, [1954] 2 Q.B. 459; *Hardy & Co. v. Hilleris & Fowler*, [1923] 2 K.B. 490 (C.A.), *per* Atkin, L.J., at p. 499; *Benjamin's Sale of Goods* (1974), para. 867.

⁸⁷Dr. Sealey, footnote 84 *supra*, at p. 244, regards the point as unsettled, but also argues that, "To hold otherwise would unnecessarily penalize the buyer when the seller is in breach."

⁸⁸UCC 2-608.

⁸⁹*Infra*, ch. 17, sec. C. 2(c).

⁹⁰White & Summers, footnote 25 *supra*, p. 149. Compare, Duesenberg and King, footnote 25 *supra*, pp. 8-54/55.

to the seller to the extent of any deficiency in the buyer's insurance coverage.

(iii) *UCC 2-510(3)*

Unlike subsections (1) and (2), this subsection is concerned with the effect on risk of breaches by the buyer. The comparison here between Code law and existing Anglo-Canadian law is more complex. Pursuant to section 21(a)⁹¹ of the Ontario Sale of Goods Act, the buyer is responsible for any loss incurred if delivery is delayed because of his fault, but only in respect of any loss that might not have occurred but for such fault. The Act does not deal with the effect on the location of risk of other breaches by the buyer. UCC 2-510(3) differs from section 21(a) in the following respects: (a) there is no requirement of proof of causality; (b) the transfer of risk to the buyer is only for a "commercially reasonable time"; (c) conformably to the principle in subsection (2), the risk is only transferred to the extent of any deficiency in the seller's insurance coverage; and, (d) the Code provision applies to any breach by the buyer after conforming goods have been identified to the contract. We support the enlarged scope of UCC 2-510(3) and its philosophy that the buyer's breach should only affect the location of risk insofar as the seller has actually been prejudiced by the breach.

The phrase "commercially reasonable time" was interpreted in *Multiplastics Inc. v. Arch Industries Inc.*⁹² to mean sufficient time to enable the seller to procure insurance coverage. We recommend that this be made clear in the revised Ontario Act. An alternative explanation⁹³ put forward for the phrase is that it covers the time necessary to enable the seller to dispose of the goods in his possession in order to avoid excessive storage costs and prolonged risk of casualty, deterioration or depreciation. We have considered whether to give effect to this construction by adding at the end of subsection (3) the words, "or to make other arrangements for their [that is, the goods'] disposition". We have concluded, however, that the addition is unnecessary.

(iv) *Conclusion*

We support the principles contained in UCC 2-510. We therefore recommend that a provision similar to UCC 2-510 be adopted in the revised Act.⁹⁴ It should, however, be made clear that the phrase "commercially reasonable time" in subsection (3) refers to the period necessary to enable the seller to procure insurance coverage.

(e) *ACTION FOR THE PRICE*

Another case in which the concept of property plays an important role in Anglo-Canadian law is found in section 47 of *The Sale of Goods*

⁹¹Supra, footnote 48.

⁹²(1974), 348 A. 2d 618 (Conn. Sup. Ct.), discussed in Duesenberg and King, footnote 25 *supra*, p. 8-61, n. 44.

⁹³Honnold, *Cases and Materials on the Law of Sales and Sales Financing* (4th ed., 1976), p. 186.

⁹⁴See, Draft Bill, s. 7.9.

Act. By virtue of this section, the seller can only claim the price where the property has passed to the buyer, unless the price is payable on a day certain. The Code rule, contained in UCC 2-709, proceeds from an entirely different premise. This rule only allows the seller to sue for the price where the buyer has accepted the goods or where, in the case of identified goods, the seller is unable to resell the goods at a reasonable price. In other cases, he is remitted to a claim in damages. The theory of the Code, as propounded by Llewellyn,⁹⁵ is that it is economically wasteful to impose unwanted goods on a buyer, especially where the seller can find a ready market for the goods. The difficult policy questions raised by section 2-709 are examined in a later chapter in this Report.⁹⁶ It will be convenient to postpone further discussion of this section until then.

(f) SALES ON APPROVAL AND CONTRACTS OF SALE OR RETURN

Some of the problems associated with these types of contract have been discussed in an earlier chapter⁹⁷ and others are discussed below.⁹⁸ *The Sale of Goods Act* has very little to say about these contracts. The only express provision appears in section 19, Rule 4, which provides presumptive indicia with respect to the time when the property passes under such contracts. By way of contrast, the Code provides "a reasoned analysis of the parties' legitimate interests".⁹⁹ The relevant provisions appear in sections 2-326 and 2-327. So far as the risk of loss is concerned, the Code distinguishes, in section 2-327(1)(a) and (2)(b), between a sale on approval and a contract of sale or return. In the former case, the risk remains with the seller until the buyer has accepted the goods; in the latter, it remains with the buyer until he returns the goods. The distinction is a sensible one and commends itself for adoption in Ontario. Accordingly, the Commission recommends that provisions similar to UCC 2-327(1)(a) and (2)(b) dealing with risk of loss in sales on approval and contracts of sale or return should be included in the revised Ontario Act.¹⁰⁰

(g) ENTITLEMENT TO SUE FOR TORT DAMAGES

Under existing common law rules, a person is only entitled to sue a third party for conversion or other wrongful interference with, or injury to, goods in the following circumstances: if he was in possession of the goods

⁹⁵According to Llewellyn:

Decently admeasured damages are all a seller needs, and are just what a seller needs, when the mercantile buyer repudiates. It is, indeed, social wisdom for the rest of us to leave the selling house, in most cases which have not involved shipment to a distant point, to dispose of whatever goods may have come into existence or into his warehouse; that is its business, and the buyer's prospective inability has been already evidenced. To force such goods on the buyer, where they are reasonably marketable by the seller, is social waste.

See, Llewellyn, footnote 15 *supra*, at pp. 176-77, also cited in Crawford footnote 1 *supra*, at p. 41.

⁹⁶*Infra*, ch. 16, sec. 3(a).

⁹⁷*Supra*, ch. 4.

⁹⁸*Infra*, ch. 12.

⁹⁹See, Crawford, footnote 1 *supra*, p. 43.

¹⁰⁰See, Draft Bill, s. 5.26.

at the time of commission of the tort; if he had an immediate right to possession coupled with a proprietary interest;¹⁰¹ or, where he is claiming permanent injury to his reversionary interest.¹⁰² These restrictions may create hardship to a seller or buyer out of possession, especially where the party in possession is unable or unwilling to take proceedings himself, or where there is a danger that he may not adequately protect the interests of the party out of possession. Following earlier American statutory precedents,¹⁰³ section 2-722 of the Code relaxes the common law requirements substantially. The section reads as follows:

2-722. Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract

- (a) a right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other;
- (b) if at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract;
- (c) either party may with the consent of the other sue for the benefit of whom it may concern.

In 1971, the English Law Reform Committee, in its *Report on Conversion and Detinue*¹⁰⁴ also applied its mind to the question of standing, but did not limit its recommendations to the sales context. The Committee recommended as follows:¹⁰⁵

. . . not only actual possession (or a right to immediate possession) at the material time, but also any other interest in a chattel, whether present or future, possessory or proprietary (but not being an equitable interest), should constitute sufficient title to sue and there should be no restriction on the right of one co-owner to sue another.

The Committee's recommendations have now been substantially imple-

¹⁰¹Benjamin's *Sale of Goods* (1974), para. 293; Fleming, *The Law of Torts* (5th ed., 1977), pp. 61-62; Vaines, *Personal Property* (5th ed., 1973), pp. 23 *et seq.*; *Jarvis v. Williams*, [1955] 1 W.L.R. 71, [1955] 1 All E.R. 108 (C.A.); and compare, *Wilson v. Lombank Ltd.*, [1963] 1 W.L.R. 1294, [1963] 1 All E.R. 740 (C.A.).

¹⁰²*Mears v. London and South Western Railway Co.* (1862), 11 C.B. (N.S.) 850, 142 E.R. 1029 (C.P.).

¹⁰³NYLRC Study, ch. 5, footnote 52, *supra*, pp. (713)-(714), citing what was then New York *Civil Practice Act*, s. 210.

¹⁰⁴Report No. 18 (Cmnd. 4774).

¹⁰⁵*Ibid.*, para. 128, recommendation 5.

mented in the *Torts (Interference with Goods) Act 1977*.¹⁰⁶ However, the Act does not appear to give express effect to the Committee's recommendation on eligible plaintiffs.¹⁰⁷ In any event, it is not clear whether "risk of loss" would have constituted a sufficient "interest in a chattel" for the purpose of the Committee's recommendation. For its part, section 2-722 of the Code also raises a substantial number of constructional difficulties,¹⁰⁸ and introduces some procedural features that may be new to Ontario.

We support the principle of UCC 2-722. However, the topic seems to extend beyond the scope of this project, and we have not, therefore, investigated the full ramifications of the two approaches to the problem, nor the merits of a provision restricted to sales as opposed to the merits of a comprehensive Act along the U.K. lines.

(h) RESIDUAL TITLE PROVISION

As previously noted, locating title at a particular moment in time is frequently of importance in non-sales situations. UCC 2-401 addresses itself to this residual group of cases, and offers a series of presumptive rules that apply unless the parties have "explicitly" provided otherwise. Whether they have done so or not, by virtue of UCC 2-401(1), title to the goods cannot pass prior to their identification to the contract. Further, any retention or reservation by the seller of the title to goods shipped or delivered to the buyer is limited in effect to the reservation of a security interest. We have previously expressed our support for this aspect of UCC 2-401(1),¹⁰⁹ which takes the place of section 20(1) of the Ontario Sale of Goods Act. We now recommend that the revised Act should adopt a provision comparable to the whole of UCC 2-401(1).¹¹⁰

Subject to the aforementioned conditions, the following rules in UCC 2-401(2) and (3) apply to determine the locus of title:

2-401.(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading

¹⁰⁶1977, c. 32 (U.K.).

¹⁰⁷Section 7 of the Act allows the claimant to sue for wrongful interference, but introduces the concept of unjust enrichment to avoid double liability on the part of the tortfeasor. Section 8 allows the tortfeasor to raise the *jus tertii* to defeat the claim of a claimant. Section 8(2) indicates that title and interest in the goods are both to be considered by the court.

¹⁰⁸For example, while risk of loss suffices for standing where goods are "destroyed or converted", does "destroyed" include partial destruction, and is it used in opposition to "casualty" in section 2-613? Is the relevant time for the existence of the plaintiff's interest the time of injury or of action, or both? In *National Compressor Corp. v. Carrow* (1969), 6 U.C.C. Rep. 1240 (8th Cir.), at least interest at the time of injury was required. Can a buyer or seller sue under section 2-722(c), even though his own interest is negligible?

¹⁰⁹*Supra*, ch. 4, p. 42.

¹¹⁰See, Draft Bill, s. 6.1(2).

- (a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but
 - (b) if the contract requires delivery at destination, title passes on tender there.
- (3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods,
- (a) if the seller is to deliver a document of title, title passes at the time when and the place where he delivers such documents; or
 - (b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting.

Subsections (2)(a) and (b) correspond to the provisions in UCC 2-509 (1)(a) and (b) and do not call for further comment. Subsection (3)(a) differs from section 2-509(2) insofar as it draws no distinction between negotiable and non-negotiable documents of title. Subsection (3)(b) also differs from section 2-509(3) by eliminating the distinction between goods in the possession of a merchant and goods in the possession of a non-merchant seller, where delivery is to be made without moving the goods. The rationale of these rules appears to be that title passes to the buyer when the seller has discharged whatever delivery responsibilities he has with respect to the goods, not whether effective control over them has passed to the buyer.

Given the wide range of circumstances in which the rules may be applied, it is not possible to say that they are either "right" or "wrong". One can only ask that they be reasonably certain and predictable. With one exception, relating to subsection (3)(b), this test seems to be met. We discuss this exception below. We now recommend¹¹¹ that the revised Act should adopt the residual title rules contained in the opening clause of subsection (2) of UCC 2-401 and in UCC 2-401(3)(a). We have not reproduced clauses (a) and (b) of UCC 2-401(2) because their contents appear to be adequately captured in the initial words of the opening clause of subsection (2), which provide that "title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods . . .".

The exception to which we refer involves future or unascertained goods that are to be delivered without physical movement. UCC 2-401 (3)(b) only applies to goods identified at the time of the contract, and no rule appears to be provided for goods not then identified. This lacuna does not appear to have attracted much attention; nor is it referred to in the Comments to UCC 2-401. However, at least some decisions¹¹² appear

¹¹¹See, Draft Bill, s. 6.1(3).

¹¹²For example, *Tatum v. Richter* (1977), 21 U.C.C. Rep. 967 (Md. Ct. App.); *First National Bank & Trust Co. v. Smithloff* (1969), 167 S.E. 2d 190 (Ga. Ct. App.).

to apply the time of identification in both types of case. This may be a logical solution, but it is open to the objection that in practice it will be difficult to determine when future goods have been identified to the contract, assuming such identification requires the consent of both parties. The solution, therefore, conflicts with the section's overriding objective of certainty and predictability.

There would appear to be two alternatives. The first would be to adopt a separate rule for the transfer of title in future or unascertained goods. The second solution would involve the adoption of a new rule that would avoid the uncertainties of an identification test, and that would govern both present and future goods where no physical movement is involved in their delivery. We favour the second alternative. Accordingly, we recommend the substitution in the revised Act of the following test for the present test in UCC 2-401(3)(b):¹¹³

. . . in any other case where delivery is to be made without moving the goods, title passes to the buyer on his receipt of the goods.

The substituted test coincides with the test we have recommended for adoption in similar circumstances involving the transfer of risk.¹¹⁴ We recognize that it involves some disadvantages where it is in the buyer's interest to argue that title passed to him before he received the goods; for example, where the goods have been paid for but not yet collected. The same objection, however, could be raised about the other rules in UCC 2-401. The inescapable fact remains that residual title rules are not functionally oriented, and can never be all things to all persons. It should be recalled that these rules will only apply where the parties have not "otherwise explicitly agreed"; that is, the parties may always adopt a rule of their choosing.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The revised Ontario Act should follow the Code's lead in abandoning a "lump" concept of title. The revised Act should adopt an issue oriented approach in which the rights, obligations and remedies of the seller, buyer, and any third party will, unless the Act otherwise provides, be determined without regard to the locus of title, and on the basis of readily observable physical facts not dependent on the subjective intentions of the parties.
2. The revised Act should incorporate the rules contained in UCC 2-501 relating to special property and insurable interest in goods.
3. The philosophy of UCC 2-509 dealing with passage of risk in the absence of breach should be reflected in the revised Ontario Act. Risk of loss should pass to the buyer not, as at present, when title to the goods is transferred, but, rather, when the goods are delivered to the buyer.

¹¹³See, Draft Bill, s. 6.1(3)2.

¹¹⁴See, Draft Bill, s. 7.8(1)3.

4. Subject to the matters dealt with in recommendations 5-8, *infra*, the revised Act should incorporate a provision similar to UCC 2-509.
5. The version of UCC 2-509(1) adopted in the revised Act should incorporate the following clarifications and changes:
 - (a) the language of subsection (1)(a) should be strengthened to make it clear that a “shipment” contract is the normal type of contract, and a “destination” contract the variant type;
 - (b) the word “duly” in the phrases “duly delivered” and “duly tendered” in subsections (1)(a) and (b) should be deleted; and
 - (c) the presumptive rule in UCC 2-509(1)(a) applicable to shipment contracts should not apply where the seller is a merchant and the buyer is not a merchant. A clause should be added providing that, in such cases, risk passes when goods are tendered to the buyer at their destination.
6. The provision in the revised Act comparable to UCC 2-509(2) should make it clear that the subsection only applies to goods held by a bailee “other than the seller”.
7. The provision in the revised Act comparable to UCC 2-509(3) should not distinguish between merchant and non-merchant sellers. Rather, in the circumstances in which the subsection applies, risk should pass to the buyer on receipt of the goods, whether or not the seller is a merchant.
8. The revised Act should not contain a specific provision dealing with the question whether the provision comparable to UCC 2-509(3) applies where the seller retains possession of the goods under an agreement of bailment.
9. The revised Act should contain a provision, similar to section 21(b) of the existing Sale of Goods Act, to the effect that the provisions on the transfer of risk shall not affect the duties or liabilities of the seller or buyer as a bailee of the goods.
10. Section 32 of the existing Ontario Act, which deals with the question of deterioration of goods in the course of transit, should be omitted from the revised Act.
11. A provision comparable to UCC 2-510 dealing with the effect of breach on risk of loss, should be incorporated in the revised Ontario Act. The revised Act should make it clear that the phrase “commercially reasonable time” in subsection (3) refers to the period necessary to enable the seller to procure insurance coverage.
12. The revised Act should include provisions similar to UCC 2-327 (1)(a) and (2)(b) dealing with risk of loss in sales on approval and contracts of sale or return.

13. Subject to recommendation No. 14, *infra*, provisions comparable to the provisions of UCC 2-401(1) and the residual title rules in the opening clause of UCC 2-401(2) and in UCC 2-401(3) should be adopted in the revised Act.
14. The residual rule contained in UCC 2-401(3)(b) involving the transfer of title where delivery is to be made without moving the goods and without delivery of a document of title should be deleted. It should be replaced by a provision, applicable to both present and future goods, to the effect that, where delivery is to be made without moving the goods, title passes to the buyer on receipt of the goods.

